NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET CHANGE 1

NCUA 8006 (M3500) DATE: December 1998

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

This is Change 1 to the National Credit Union Administration Rules and Regulations (Revised August 1998).

1. **PURPOSE.** To update the National Credit Union Administration Rules and Regulations (Revised August 1998) in the following manner:

a. **Section 701.21—Loans to members and Lines of Credit to Members.** Amended paragraph (c)(5) by revising § 701.21(h)(1)(ii) to read "§ 723.1 of this chapter" and § 701.21(h)(2)(ii) to read "§§ 723.8 and 723.9 of this chapter."

b. **Section 701.21(h)—***Member Business Loans.* Removed and reserved.

c. **Section 722.3 Appraisals required; transactions requiring a State certified or licensed appraiser.** Amended by removing "or" at the end of paragraph (a)(7); by removing the period at the end of paragraph (a)(8)(ii) and adding "; or" in its place, and by adding a new paragraph (a)(9).

d. **Part 723—Member Business Loans**—New part added. Revised member business loans regulation previously found at § 701.21(h).

e. **Section 741.203**—Amended paragraph (a) by revising "§ 702.21(h)" to read "part 723."

2. **INSTRUCTIONS:**

a. Your August 1998 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–xii	i–xii
701–11 thru 701–31	701–11 thru 701–26
722–1 thru 722–4	722–1 thru 722–4
None	723–1 thru 723–5
741–5 thru 741–6	741–5 thru 741–6

b. On September 30, 1998, the NCUA adopted, as a final rule, the interim final amendments to part 724. These amendments authorized Federal Credit Unions to act as trustees and custodians for Roth IRAs and Education IRAs. The NCUA Board made no changes to the interim final amendments except to make the amendments effective as of January 1, 1998. The interim final amendments are already a part of this publication, hence only the premable, along with the Federal Register published preamble to the new final member business loans rule are provided. The preambles are not part of the rules, but you may find them useful for explanatory purposes.

TABLE OF CONTENTS

*THESE PARTS APPLY TO FEDERALLY INSURED STATE-CHARTERED CREDIT UNIONS AS WELL AS FEDERAL CREDIT UNIONS

TABLE OF CONTENTS

*THESE PARTS APPLY TO FEDERALLY INSURED STATE-CHARTERED CREDIT UNIONS AS WELL AS FEDERAL CREDIT UNIONS

TABLE OF CONTENTS

*THESE PARTS APPLY TO FEDERALLY INSURED STATE-CHARTERED CREDIT UNIONS AS WELL AS FEDERAL CREDIT UNIONS

TABLE OF CONTENTS

*THESE PARTS APPLY TO FEDERALLY INSURED STATE-CHARTERED CREDIT UNIONS AS WELL AS FEDERAL CREDIT UNIONS

TABLE OF CONTENTS

*THESE PARTS APPLY TO FEDERALLY INSURED STATE-CHARTERED CREDIT UNIONS AS WELL AS FEDERAL CREDIT UNIONS

TABLE OF CONTENTS

*THESE PARTS APPLY TO FEDERALLY INSURED STATE-CHARTERED CREDIT UNIONS AS WELL AS FEDERAL CREDIT UNIONS

TABLE OF CONTENTS

*THESE PARTS APPLY TO FEDERALLY INSURED STATE-CHARTERED CREDIT UNIONS AS WELL AS FEDERAL CREDIT UNIONS

TABLE OF CONTENTS

TABLE OF CONTENTS

Section *Page*

TABLE OF CONTENTS

*THESE PARTS APPLY TO FEDERALLY INSURED STATE-CHARTERED CREDIT UNIONS AS WELL AS FEDERAL CREDIT UNIONS

TABLE OF CONTENTS

TABLE OF CONTENTS

(3) *Other Federal law.* Except as provided by Section 701.21(b)(1), it is not the Board's intent to preempt state laws affecting aspects of credit transactions that are primarily regulated by Federal law other than the Federal Credit Union Act, for example, state laws concerning credit cost disclosure requirements, credit discrimination, credit reporting practices, unfair credit practices, and debt collection practices. Applicability of state law in these instances should be determined pursuant to the preemption standards of the relevant Federal law and regulations.

(4) *Examination and Enforcement.* Except as otherwise agreed by the NCUA Board, the Board retains exclusive examination and administrative enforcement jurisdiction over Federal credit unions. Violations of Federal or applicable state laws related to the lending activities of a Federal credit union should be referred to the appropriate NCUA regional office.

(5) *Definition of State Law.* For purposes of Section 701.21(b) "state law" means the constitution, laws, regulations and judicial decisions of any state, the District of Columbia, the several territories and possessions of the United States, and the Commonwealth of Puerto Rico.

(c) *General Rules:*

(1) *Scope.* The following general rules apply to all loans to members and, where indicated, all lines of credit (including credit cards) to members, except as otherwise provided in the remaining provisions of Section 701.21.

(2) *Written policies.* The board of directors of each Federal credit union shall establish written policies for loans and lines of credit consistent with the relevant provisions of the Act, NCUA's regulations, and other applicable laws and regulations.

(3) *Credit application.* Consistent with policies established by the board of directors, the credit committee or loan officer shall ensure that a credit application is kept on file for each borrower supporting the decision to make a loan or establish a line of credit.

(4) *Maturity.* The maturity of a loan to a member may not exceed 12 years. Lines of credit are not subject to a statutory or regulatory maturity limit. Amortization of line of credit balances and the type and amount of security on any line of credit shall be as determined by contract between the Federal credit union and the member/borrower.

(5) *Ten percent limit.* No loan or line of credit advance may be made to any member if such loan or advance would cause that member to be indebted to the Federal credit union upon loans and advances made to the member in an aggregated amount exceeding 10% of the credit union's total unimpaired shares and surplus. In the case of member business loans as defined in § 723.1 of this chapter. Additional limitations apply as set forth in §§ 723.8 and 723.9 of this chapter.

(6) *Early payment.* A member may repay a loan, or outstanding balance on a line of credit, prior to maturity in whole or in part on any business day without penalty.

(7) *Loan interest rates.*

(i) *General.* Except when a higher maximum rate is provided for in 701.21(c)(7)(ii), a Federal credit union may extend credit to its members at rates not to exceed 15 percent per year on the unpaid balance inclusive of all finance charges. Variable rates are permitted on the condition that the effective rate over the term of the loan (or line of credit) does not exceed the maximum permissible rate.

(ii) *Temporary rates.—(A) 21 percent maximum rate.* Effective from December 3, 1980 through May 14, 1987, a Federal credit union may extend credit to its members at rates not to exceed 21 percent per year on the unpaid balance inclusive of all finance charges. Loans and line of credit balances existing on or before May 14, 1987, may continue to bear rates of interest of up to 21 percent per year after May 14, 1987.

(B) *18 percent maximum rate.* Effective May 15, 1987, a Federal credit union may extend credit to its members at rates not to exceed 18 percent per year on the unpaid balance inclusive of all finance charges.

(C) *Expiration.* After March 8, 1999, or as otherwise ordered by the NCUA Board, the maximum rate on federal credit union extensions of credit to members shall revert to 15 percent per year. Higher rates may, however, be charged, in accordance with paragraphs (c)(7)(ii)(A) and (B) of this section, on loans and line of credit balances existing on or before March 8, 1999.

(8)(i) Except as otherwise provided herein, no official or employee of a Federal credit union, or immediate family member of an official or employee of a Federal credit union, may receive, directly or indirectly, any commission, fee, or other compensation in connection with any loan made by the credit union.

(ii) For the purposes of this section:

Compensation includes non monetary items, except those of nominal value.

Immediate family member means a spouse or other family member living in the same household.

Loan includes line of credit.

Official means any member of the board of directors or a volunteer committee.

Person means an individual or an organization.

Senior management employee means the credit union's chief executive officer (typically, this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President, or Assistant Treasurer/Manager), and the chief financial officer (Comptroller).

Volunteer official means an official of a credit union who does not receive compensation from the credit union solely for his or her service as an official.

(iii) This section does not prohibit:

(A) Payment, by a Federal credit union, of salary to employees;

(B) Payment, by a Federal credit union, of an incentive or bonus to an employee based on the credit union's overall financial performance;

(C) Payment, by a Federal credit union, of an incentive or bonus to an employee, other than a senior management employee, in connection with a loan or loans made by the credit union, provided that the board of directors of the credit union establishes written policies and internal controls in connection with such incentive or bonus and monitors compliance with such policies and controls at least annually.

(D) Receipt of compensation from a person outside a Federal credit union by a volunteer official or non senior management employee of the credit union, or an immediate family member of a volunteer official or employee of the credit union, for a service or activity performed outside the credit union, provided that no referral has been made by the credit union or the official, employee, or family member.

(d) *Loans and Lines of Credit to Officials:*

(1) *Purpose.* Sections 107(5)(A) (iv) and (v) of the Act require the approval of the board of directors of the Federal credit union in any case where the aggregate of loans to an official and loans on which that official serves as endorser or guarantor exceeds $20,000 plus pledged shares. This Section (701.21(d)) implements the requirement by establishing procedures for determining whether board of directors' approval is required. The section also prohibits preferential treatment of officials.

(2) *Official.* An "official" is any member of the board of directors, credit committee or supervisory committee.

(3) *Initial approval.* All applications for loan or lines of credit on which an official will be either a direct obligor or an endorser, cosigner or guarantor shall be initially acted upon by either the board of directors, the credit committee or loan officer, as specified in the Federal credit union's bylaws.

(4) *Board of directors' review.* The board of directors shall, in any case, review and approve or deny an application on which an official is a direct obligor, or endorser, cosigner or guarantor if the following computation produces a total in excess of $20,000:

(i) Add:

(A) The amount of the current application.

(B) The outstanding balances of loans including the used portion of an approved line of credit, extended to or endorsed, cosigned or guaranteed by the official.

(C) The total unused portion of approved lines of credit extended to or endorsed, cosigned or guaranteed by the official.

(ii) From the above total subtract:

(A) the amount of shares pledged by the official on loans or lines of credit extended to or endorsed, cosigned or guaranteed by the official.

(B) The amount of shares to be pledged by the official on the loan or line of credit applied for.

(5) *Nonpreferential treatment.* The rates, terms and conditions on any loan or line of credit either made to, or endorsed or guaranteed by

(i) an official

(ii) an immediate family member of an official, or

(iii) any individual having a common ownership, investment or other pecuniary interest in a business enterprise with an official or with an immediate family member of an official shall not be more favorable than the rates, terms and conditions for comparable loans or lines of credit to other credit union members. "Immediate family members" means a spouse or other family member living in the same household.

(e) *Insured, Guaranteed and Advance Commitment Loans.* A loan secured by the insurance or guarantee of, or with an advance commitment to purchase the loan by, the Federal Government, a State government, or any agency of either, may be made for the maturity and under the terms and conditions, including rate of interest, specified in the law, regulations or program under which the insurance, guarantee or commitment is provided.

(f) *20-Year Loans.* Notwithstanding the general 12-year maturity limit on loans to members, a Federal credit union may make loans with maturities of up to 20 years in the case of: (1) a loan to finance the purchase of a mobile home if the mobile home will be used as the member-borrower's residence and the loan is secured by a first lien on the mobile home, (2) a second mortgage loan (or a nonpurchase money first mortgage loan in the case of a residence on which there is no existing first mortgage) if the loan is secured by a residential dwelling which is the residence of the member-borrower, and (3) a loan to finance the repair, alteration, or improvement of a residential dwelling which is the residence of the member-borrower.

(g) *Long-Term Mortgage Loans:*

(1) *Authority.* A Federal credit union may make residential real estate loans to members, with maturities of up to 40 years, or such longer period as may be permitted by the NCUA Board on a case-by-case basis, subject to the conditions of this Section (701.21(g)).

(2) *Statutory limits.* The loan shall be made on a one- to four-family dwelling that is or will be the principal residence of the member-borrower and the loan shall be secured by a perfected first lien in favor of the credit union on such dwelling (or a perfected first security interest in the case of either a residential cooperative or a leasehold or ground rent estate).

(3) *Loan application.* The loan application shall be a completed standard Federal Housing Administration, Veterans Administration, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association or Federal Home Loan Mortgage Corporation/Federal National Mortgage Association application form. In lieu of use of a standard application the Federal credit union may have a current attorney's opinion on file stating that the forms in use meet the requirements of applicable Federal, state and local laws.

(4) *Security instrument and note.* The security instrument and note shall be executed on the most current version of the FHA, VA, FHLMC, FNMA, or FHLMC/FNMA Uniform Instruments for the jurisdiction in which the property is located. No prepayment penalty shall be allowed, although a Federal credit union may require that any partial prepayments be made on the date monthly installments are due and be in the amount of that part of one or more monthly installments that would be applicable to principal. In lieu of use of a standard security instrument and note, the Federal credit union may have a current attorney's opinion on file stating that the security instrument and note in use meet the requirements of applicable Federal, state and local laws.

(5) *First lien, territorial limits.* The loan shall be secured by a perfected first lien or first security interest in favor of the credit union supported by a properly executed and recorded security instrument. No loan shall be secured by a residence located outside the United States of America, its territories and possessions, or the Commonwealth of Puerto Rico.

(6) *Due-on-sale clauses:*

(i) Except as otherwise provided herein, the exercise of a due-on-sale clause by a Federal credit union is governed exclusively by Section 341 of Public Law 97–320 and by any regulations issued by the Federal Home Loan Bank Board implementing Section 341.

(ii) In the case of a contract involving a long-term (greater than twelve years), fixed rate first mortgage loan which was made or assumed, including a transfer of the liened property subject to the loan, during the period beginning on the date a state adopted a constitutional provision or statute prohibiting the exercise of due-on-sale clauses, or the date on which the highest court of such state has rendered a decision (or if the highest court has not so decided, the date on which the next highest court has rendered a decision resulting in a final judgment if such decision applies statewide) prohibiting such exercise, and ending on October 15, 1982, a Federal credit union may exercise a due-on-sale clause in the case of a transfer which occurs on or after November 18, 1982, unless exercise of the due-on-sale clause would be based on any of the following:

(A) the creation of a lien or other encumbrance subordinate to the lender's secu-

rity instrument which does not relate to a transfer of rights of occupancy in the property;

(B) the creation of a purchase money security interest for household appliances;

(C) a transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety;

(D) the granting of a leasehold interest of 3 years or less not containing an option to purchase;

(E) a transfer to a relative resulting from the death of a borrower;

(F) a transfer where the spouse or children of the borrower become an owner of the property;

(G) a transfer resulting from a decree of a dissolution of marriage, a legal separation agreement, or from an incidental property settlement agreement, by which the spouse of the borrower becomes an owner of the property;

(H) a transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property; or

(I) any other transfer or disposition described in regulations promulgated by the Federal Home Loan Bank Board.

(h) *Removed and replaced by part 723.*

(i) *Put Option Purchases in Managing Increased Interest-Rate Risk for Real Estate Loans Produced for Sale on the Secondary Market.*

(1) *Definitions.* For purposes of this § 701.21(i):

(i) "Financial options contact" means an agreement to make or take delivery of a standardized financial instrument upon demand by the holder of the contract at any time prior to the expiration date specified in the agreement, under terms and conditions established either by (A) a contract market designated for trading such contracts by the Commodity Futures Trading Commission, or (B) by a Federal credit union and a primary dealer in Government securities that are counterparties in an over-the-counter transaction.

(ii) "FHLMC security" means obligations or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to Sections 305 or 306 of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. §§ 1454 and 1455).

(iii) "FNMA security" means an obligation, participation, or any instrument of or issued by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association.

(iv) "GNMA security" means an obligation, participation, or any instrument of or issued by, or fully guaranteed as to principal and interest by, the Government National Mortgage Association.

(v) "Long position" means the holding of a financial options contract with the option to make or take delivery of a financial instrument.

(vi) "Primary dealer in Government securities" means: (A) a member of the Association of Primary Dealers in United States Government Securities; or (B) any parent, subsidiary, or affiliated entity of such primary dealer where the member guarantees (to the satisfaction of the FCU's board of directors) over-the-counter sales of financial options contracts by the parent, subsidiary, or affiliated entity to a Federal credit union.

(vii) "Put" means a financial options contract which entitles the holder to sell, entirely at the holder's option, a specified quantity of a security at a specified price at any time until the stated expiration date of the contract.

(2) *Permitted Options Transactions.* A Federal credit union may, to manage risk of loss through a decrease in value of its commitments to originate real estate loans at specified interest rates, enter into long put positions on GNMA, FNMA, and FHLMC securities:

(i) if the real estate loans are to be sold on the secondary market within ninety (90) days of closing;

(ii) if the positions are entered into: (A) through a contract market designated by the Commodity Futures Trading Commission for trading such contracts, or (B) with a primary dealer in Government securities;

(iii) if the positions are entered into pursuant to written policies and procedures which are approved by the Federal credit union's board of directors, and include, at a minimum: (A) the Federal credit union's strategy in using financial options contracts and its analysis of how the strategy will reduce sensitivity to changes in price or interest rates in its commitments to originate real estate loans at specified interest rates; (B) a list of brokers or other intermediaries through which positions may be entered into; (C) quantitative limits (e.g., position and stop loss limits) on the use of financial options contracts; (D) identification of the persons involved in financial options contract transactions, including a description of

these persons' qualifications, duties, and limits of authority, and description of the procedures for segregating these persons' duties, (E) a requirement for written reports for review by the Federal credit union's board of directors at its monthly meetings, or by a committee appointed by the board on a monthly basis, of: (1) the type, amount, expiration date, correlation, cost of, and current or projected income or loss from each position closed since the last board review, each position currently open and current gains or losses from such positions, and each position planned to be entered into prior to the next board review; (2) compliance with limits established on the policies and procedures; and (3) the extent to which the positions described contributed to reduction of sensitivity to changes in prices or interest rates in the Federal credit union's commitments to originate real estate loans at a specified interest rate; and

(iv) if the Federal credit union has received written permission from the appropriate NCUA Regional Director to engage in financial options contracts transactions in accordance with this § 701.21(i) and its policies and procedures as written.

(3) *Recordkeeping and Reporting.*

(i) The reports described in § 701.21 (i)(2)(iii)(E) for each month must be submitted to the appropriate NCUA Regional Office by the end of the following month. This monthly reporting requirement may be waived by the appropriate NCUA Regional Director on a case-by-case basis for those Federal credit unions with a proven record of responsible use of permitted financial options contracts.

(ii) The records described in § 701.21 (i)(2)(iii)(E) must be retained for two years from the date the financial options contracts are closed.

(4) *Accounting.* A Federal credit union must account for financial options contracts transactions:

(i) in accordance with standards established by the NCUA Board in the Accounting Manual for Federal Credit Unions, available from NCUA, Administrative Office, 1775 Duke Street, Alexandria, VA 22314, or such other instruction as may be deemed appropriate; or

(ii) to the extent not inconsistent with NCUA Board instructions, in accordance with generally accepted accounting standards or principles.

§ 701.22 Loan Participation.

(a) For purposes of this section:

(1) "Participation loan" means a loan where one or more eligible organizations participates pursuant to a written agreement with the originating lender.

(2) "Eligible organizations" means a credit union, credit union organization, or financial organization.

(3) "Credit union" means any Federal or state chartered credit union.

(4) "Credit union organization" means any organization as determined by the Board, established primarily to serve the daily operational needs of its member credit unions. The term does not include trade associations, membership organizations principally composed of credit unions, or corporations or other businesses which principally provide services to credit union members as opposed to corporations or businesses whose business relates to the daily in-house operation of credit unions.

(5) "Financial organization" means any federally chartered or federally insured financial institution.

(6) "Originating lender" means the participant with which the member contracts.

(b) Subject to the provisions of this section any Federal credit union may participate in making loans with eligible organizations within the limitations of the board of directors' written participation loan policies, PROVIDED:

(1) no Federal credit union shall obtain an interest in a participation loan if the sum of that interest and any (other) indebtedness owing to the Federal credit union by the borrower exceeds 10 per centum of the Federal credit union's unimpaired capital and surplus;

(2) a written master participation agreement shall be properly executed, acted upon by the Federal credit union's board of directors, or if the board has so delegated in its policy, the investment committee or senior management offical(s) and retained in the Federal credit union's office. The master agreement shall include provisions for identifying, either through a document which is incorporated by reference into the master agreement, or directly in the master agreement, the participation loan or loans prior to their sale; and

(3) a Federal credit union may sell to or purchase from any participant the servicing of

any loan in which it owns a participation interest.

(c) An originating lender which is a Federal credit union shall:

(1) originate loans only to its members;

(2) retain an interest of at least 10 per centum of the face amount of each loan;

(3) retain the original or copies of the loan documents; and

(4) Require the credit committee or loan officer to use the same underwriting standards for participation loans used for loans that are not being sold in a participation agreement unless there is a participation agreement in place prior to the disbursement of the loan. Where a participation agreement is in place prior to disbursement, either the credit union's loan policies or the participation agreement shall address any variance from non-participation loan underwriting standards.

(d) A participant Federal credit union that is not an originating lender shall:

(1) participate only in loans it is empowered to grant, having a participation policy in place which sets forth the loan underwriting standards prior to entering into a participation agreement;

(2) participate in participation loans only if made to its own members or members of another participating credit union;

(3) retain the original or a copy of the written participation loan agreement and a schedule of the loans covered by the agreement; and

(4) obtain the approval of the board of directors or investment committee of the disbursement of proceeds to the originating lender.

§ 701.23 Purchase, Sale, and Pledge of Eligible Obligations.

(a) For purposes of this Section:

(1) "Eligible obligation" means a loan or group of loans;

(2) "Student loan" means a loan granted to finance the borrower's attendance at an institution of higher education or at a vocational school, which is secured by and on which payment of the outstanding principal and interest has been deferred in accordance with the insurance or guarantee of the Federal Government, of a State government, or any agency of either.

(b) Purchase.

(1) A Federal credit union may purchase, in whole or in part, within the limitations of the board of directors' written purchase policies:

(i) Eligible obligations of its members, from any source, if either (A) they are loans it is empowered to grant or (B) they are refinanced with the consent of the borrowers, within 60 days after they are purchased, so that they are loans it is empowered to grant;

(ii) Eligible obligations of a liquidating credit union's individual members, from the liquidating credit union;

(iii) Student loans, from any source, if the purchaser is granting student loans on an ongoing basis and if the purchase will facilitate the purchasing credit union's packaging of a pool of such loans to be sold or pledged on the secondary market; and

(iv) Real estate-secured loans, from any source, if the purchaser is granting real estate secured loans pursuant to Section 701.21 on an ongoing basis and if the purchase will facilitate the purchasing credit union's packaging of a pool of such loans to be sold or pledged on the secondary mortgage market.

(2) A Federal credit union may make purchases in accordance with this paragraph (b), provided:

(i) the board of directors or investment committee approves the purchase;

(ii) a written agreement and a schedule of the eligible obligations covered by the agreement are retained in the purchaser's office; and for purchases under paragraph (b)(1)(ii) of this section, any advance written approval required by § 741.8 of this chapter is obtained before consummation of such purchase.

(3) The aggregate of the unpaid balance of eligible obligations purchased under paragraph (b) shall not exceed 5 percent of the unimpaired capital and surplus of the purchaser. Student loans purchased in accordance with paragraph (b)(1)(iii), real estate loans purchased in accordance with paragraph (b)(1)(iv), and eligible obligations purchased in accordance with paragraph (b)(1)(i) that are refinanced by the purchaser so that they are loans it is empowered to grant shall not be included in considering this 5 percent limitation.

(c) Sale.

(1) A Federal credit union may sell, in whole or in part, to any source, eligible obligations of its members, eligible obligations purchased in accordance with subsection (b)(1)(ii), student loans purchased in accordance with subsection (b)(1)(iii), and real estate loans purchased in accordance with subsection (b)(1)(iv),

within the limitations of the board of directors' written sale policies, provided:

(i) The board of directors or investment committee approves the sale; and

(ii) A written agreement and a schedule of the eligible obligations covered by the agreement are retained in the seller's office.

(d) Pledge.

(1) A Federal credit union may pledge, in whole or in part, to any source, eligible obligations of its members, eligible obligations purchased in accordance with subsection (b)(1)(ii), student loans purchased in accordance with subsection (b)(1)(iii), and real estate loans purchased in accordance with subsection (b)(1)(iv), within the limitations of the board of directors' written pledge policies, provided:

(i) The board of directors or investment committee approves the pledge;

(ii) Copies of the original loan documents are retained; and

(iii) A written agreement covering the pledging arrangement is retained in the office of the credit union that pledges the eligible obligations.

(2) The pledge agreement shall identify the eligible obligations covered by the agreement.

(e) Servicing.

A Federal credit union may agree to service any eligible obligation it purchases or sells in whole or in part.

(f) 10 Percent Limitation.

The total indebtedness owing to any Federal credit union by any person, inclusive of retained and reacquired interests, shall not exceed 10 percent of its unimpaired capital and surplus.

§ 701.24 Refund of Interest.

(a) The board of directors of a Federal credit union may authorize an interest refund to members who paid interest to the credit union during any dividend period and who are members of record at the close of business on the last day of such dividend period. Interest refunds may be made for a dividend period only if dividends on share accounts have been declared and paid for that period.

(b) The amount of interest refund to each member shall be determined as a percentage of the interest paid by the member. Such percentage may vary according to the type of extension of credit and the interest rate charged.

(c) The board of directors may exclude from an interest refund: (1) a particular type of extension of credit; (2) any extension of credit made at a particular interest rate; and (3) any extension of credit that is presently delinquent or has been delinquent within the period for which the refund is being made.

§ 701.25 [Reserved]

§ 701.26 Credit Union Service Contracts.

A Federal credit union may act as a representative of and enter into a contractual agreement with one or more credit unions or other organizations for the purpose of sharing, utilizing, renting, leasing, purchasing, selling, and/or joint ownership of fixed assets or engaging in activities and/or services which relate to the daily operations of credit unions. Agreements must be in writing, and shall advise all parties subject to the agreement that the goods and services provided shall be subject to examination by the NCUA Board to the extent permitted by law.

§ 701.27 [Removed April 1998, replaced by new part 712]

§§ 701.28–701.29 [Reserved]

§ 701.30 Safe Deposit Box Service.

A Federal credit union may lease safe deposit boxes to its members.

§ 701.31 Nondiscrimination Requirements.

(a) *Definitions:* As used in this part, the term:

(1) "application" carries the meaning of that term as defined in 12 C.F.R. 202.2(f) (Regulation B), which is as follows: "An oral or written request for an extension of credit that is made in accordance with procedures established by a creditor for the type of credit requested";

(2) "dwelling" carries the meaning of that term as defined in 42 U.S.C. 3602(b) (Fair Housing Act), which is as follows: "Any building, structure, or portion thereof which is occupied as, or designed or intended for occupancy as, a residence by one or more families, and any vacant land which is offered for sale or lease for

the construction or location thereon of any building, structure, or portion thereof"; and

(3) "real estate-related loan" means any loan for which application is made to finance or refinance the purchase, construction, improvement, repair, or maintenance of a dwelling.

(b) *Nondiscrimination in Lending:*

(1) A Federal credit union may not deny a real estate-related loan, nor may it discriminate in setting or exercising its rights pursuant to the terms or conditions of such a loan, nor may it discourage an application for such a loan, on the basis of the race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18) of:

(i) any applicant or joint applicant;

(ii) any person associated, in connection with a real estate-related loan application, with an applicant or joint applicant;

(iii) the present or prospective owners, lessees, tenants, or occupants of the dwelling for which a real estate-related loan is requested;

(iv) the present or prospective owners, lessees, tenants, or occupants of other dwellings in the vicinity of the dwelling for which a real estate-related loan is requested.

(2) With regard to a real estate-related loan, a Federal credit union may not consider a lending criterion or exercise a lending policy which has the effect of discriminating on the basis of race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18). Guidelines concerning possible exceptions to this provision appear in paragraph (e)(1) of this section.

(3) Consideration of any of the following factors in connection with a real estate-related loan is not necessary to a Federal credit union's business, generally has a discriminatory effect, and is therefore prohibited:

(i) the age or location of the dwelling;

(ii) zip code of the applicant's current residence;

(iii) previous home ownership;

(iv) the age or location of dwellings in the neighborhood of the dwelling;

(v) the income level of residents in the neighborhood of the dwelling;

Guidelines concerning possible exceptions to this provision appear in paragraph (e)(2) of this section.

(c) *Nondiscrimination in Appraisals:*

(1) A Federal credit union may not rely upon an appraisal of a dwelling if it knows or should know that the appraisal is based upon consideration of the race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18) of:

(i) any applicant or joint applicant;

(ii) any person associated, in connection with a real estate-related loan application, with an applicant or joint applicant;

(iii) the present or prospective owners, lessees, tenants, or occupants of the dwelling for which a real estate-related loan is requested;

(iv) the present or prospective owners, lessees, tenants, or occupants of other dwellings in the vicinity of the dwelling for which a real estate-related loan is requested.

(2) With respect to a real estate-related loan, a Federal credit union may not rely upon an appraisal of a dwelling if it knows or should know that the appraisal is based upon consideration of a criterion which has the effect of discriminating on the basis of race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18). Guidelines concerning possible exceptions to this provision appear in paragraph (e)(1) of this section.

(3) A Federal credit union may not rely upon an appraisal that it knows or should know is based upon consideration of any of the following criteria, for such criteria generally have a discriminatory effect, and are not necessary to a Federal credit union's business:

(i) the age or location of the dwelling;

(ii) the age or location of dwellings in the neighborhood of the dwelling;

(iii) the income level of the residents in the neighborhood of the dwelling.

(4) Notwithstanding paragraph (c)(3) of this section, it is recognized that there may be factors concerning location of the dwelling which can be properly considered in an appraisal. If any such factor(s) is relied upon, it must be specifically documented in the appraisal, accompanied by a brief statement demonstrating the necessity of using such factor(s). Guidelines concerning the consideration of location factors appear in paragraph (e)(3) of this section.

(5) Each Federal credit union shall make available, to any requesting member/applicant, a copy of the appraisal used in connection with that member's real estate-related loan application. The appraisal shall be available for a period of 25 months after the applicant has received notice from the Federal credit union of the action taken by the Federal credit union on the real estate-related loan application.

(d) *Nondiscrimination in Advertising:*

(1) *Advertising notice of nondiscrimination compliance.*

(i) No Federal credit union may directly or indirectly engage in any form of advertising of real estate-related loans which implies or suggests that the Federal credit union discriminates in violation of the provisions of the Fair Housing Act or of this section. Advertisements of such loans shall include a facsimile of the following:

We Do Business in Accordance With the Federal Fair Housing Law and the Equal Credit Opportunity Act

(ii) Advertisements of real estate-related loans which are broadcast on the radio shall contain the following statement: "The (insert name) Federal Credit Union is an equal housing lender."

(2) *Lobby notice of nondiscrimination compliance.* Every Federal credit union which engages in real estate-related lending shall conspicuously display in the public lobby of such credit union and in the public area of each office where such loans are made, in a manner so as to be clearly visible to the general public entering such lobby or area, a notice that incorporates a facsimile of the logotype and notice appearing in paragraph (d)(3) of this section. Posters containing this notice and logotype may be obtained from the Regional Offices of the National Credit Union Administration.

(3) *Logotype and notice of nondiscrimination compliance.* The logotype and text of the notice required in paragraph (d)(2) of this section shall be as follows:

We Do Business in Accordance With the Federal Fair Lending Laws

UNDER THE FEDERAL FAIR HOUSING ACT, IT IS ILLEGAL, ON THE BASIS OF RACE, COLOR, NATIONAL ORIGIN, RELIGION, SEX, HANDICAP, OR FAMILIAL STATUS (HAVING CHILDREN UNDER THE AGE OF 18), TO:

- Deny a loan for the purpose of purchasing, constructing, improving, repairing or maintaining a dwelling, or deny any loan secured by a dwelling; or
- Discrimination in fixing the amount, interest rate, duration, application procedures or other terms or conditions of such a loan, or in appraising property.

IF YOU BELIEVE YOU HAVE BEEN DISCRIMINATED AGAINST, YOU SHOULD SEND A COMPLAINT TO:

Assistant Secretary for Fair Housing and Equal Opportunity
Department of Housing & Urban Development
Washington, D.C. 20410
For processing under the Federal Fair Housing Act
and to:
National Credit Union Administration
Office of Examination and Insurance
1775 Duke Street
Alexandria, VA 22314–3428
For processing under NCUA Regulations

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UNDER THE EQUAL CREDIT OPPORTUNITY ACT, IT IS ILLEGAL TO DISCRIMINATE IN ANY CREDIT TRANSACTION:

- On the basis of race, color, national origin, religion, sex, marital status, or age
- Because income is from public assistance, or
- Because a right was exercised under the Consumer Credit Protection Act.

IF YOU BELIEVE YOU HAVE BEEN DISCRIMINATED AGAINST, YOU SHOULD SEND A COMPLAINT TO:

National Credit Union Administration
Office of Examination and Insurance
1775 Duke Street
Alexandria, VA 22314–3428

(e) *Guidelines:*

(1) Compliance with the Fair Housing Act is achieved when each loan applicant's creditworthiness is evaluated on an individual basis, without presuming that the applicant has certain characteristics of a group. If certain lending policies or procedures do presume group characteristics, they may violate the Fair Housing Act, even though the characteristics are not based upon race, color, sex, national origin, religion, handicap, or familial status. Such a violation occurs when otherwise facially nondiscriminatory lending procedures (either general lending policies or specific criteria used in reviewing loan applications) have the effect of making real estate-related loans unavailable or less available on the basis of race, color, sex, national origin, religion, handicap, or familial status. Note, however, that a policy or criterion which has a discriminatory effect is not a violation of

the Fair Housing Act if its use achieves a legitimate business necessity which cannot be achieved by using less discriminatory standards. It is also important to note that the Equal Credit Opportunity Act and Regulation B prohibit discrimination, either per se or in effect, on the basis of the applicant's age, marital status, receipt of public assistance, or the exercise of any rights under the Consumer Credit Protection Act.

(2) Paragraph (b)(3) of this section prohibits consideration of certain factors because of their likely discriminatory effect and because they are not necessary to make sound real estate-related loans. For purposes of clarification, the prohibited use of location factors in this section is intended to prevent abandonment of areas in which a Federal credit union's members live or want to live. It is not intended to require loans in those areas that are geographically remote from the FCU's main or branch offices or that contravene the parameters of a Federal credit union's charter. Further. this prohibition does not preclude requiring a borrower to obtain flood insurance protection pursuant to the National Flood Insurance Act and Part 760 of NCUA's Rules and Regulations, nor does it preclude involvement with Federal or state housing insurance programs which provide for lower interest rates for the purchase of homes in certain urban or rural areas. Also, the legitimate use of location factors in an appraisal does not constitute a violation of the provision of paragraph (b)(3) of this section, which prohibits consideration of location of the dwelling. Finally, the prohibited use of prior home ownership does not preclude a Federal credit union from considering an applicant's payment history on a loan which was made to obtain a home. Such action entails consideration of the payment record on a previous loan in determining creditworthiness; it does not entail consideration of prior home ownership.

(3)(i) Paragraph (c)(3) of this section prohibits consideration of the age or location of a dwelling in a real estate-related loan appraisal. These restrictions are intended to prohibit the use of unfounded or unsubstantiated assumptions regarding the effect upon loan risk of the age of a dwelling or the physical or economic characteristics of an area. Appraisals should be based on the present market value of the property offered as security (including consideration of specific improvements to be made by the borrower) and the likelihood that the property will retain an adequate value over the term of the loan.

(ii) The term "age of the dwelling" does not encompass structural soundness. In addition, the age of the dwelling may be used by an appraiser as a basis for conducting further inspections of certain structural aspects of the dwelling. Paragraph (c)(3) of this section does, however, prohibit an unsubstantiated determination that a house over X years in age is not structurally sound.

(iii) With respect to location factors, paragraph (c)(4) of this section recognizes that there may be location factors which may be considered in an appraisal, and requires that the use of any such factors be specifically documented in the appraisal. These factors will most often be those location factors which may negatively affect the short range future value (up to 3–5 years) of a property. Factors which in some cases may cause the market value of a property to decline are recent zoning changes or a significant number of abandoned homes in the immediate vicinity of the property. However, not all zoning changes will cause a decline in property values, and proximity to abandoned buildings may not affect the market value of a property because the cause of abandonment is unrelated to high risk. Proper considerations include the condition and utility of the improvement and various physical factors such as street conditions, amenities such as parks and recreation areas, availability of public utilities and municipal services and exposure to flooding and land faults.

§ 701.32 Payment on shares by public units and nonmembers.

(a) *Authority.* A Federal credit union may, to the extent permitted under Section 107(6) of the Act and this section, receive payments on shares, (regular shares, share certificates, and share draft accounts) from public units and political subdivisions thereof (as those terms are defined in § 745.1) and nonmember credit unions, and to the extent permitted under the Act, this section and § 701.34, receive payments on shares (regular shares, share certificates, and share draft accounts) from other nonmembers.

(b) *Limitations.* (1) Unless a greater amount has been approved by the Regional Director, the maximum amount of all public unit and nonmember shares shall not, at any given time, exceed 20%

of the total shares of the federal credit union or $1.5 million, whichever is greater.

(2) Before accepting any public unit or nonmember shares in excess of 20% of total shares, the board of directors must adopt a specific written plan concerning the intended use of these shares and forward a copy of the plan to the Regional Director. The plan must include:

(i) A statement of the credit union's needs, sources and intended uses of public unit and nonmember shares;

(ii) Provision for matching maturities of public unit and nonmember shares with corresponding assets, or justification for any mismatch; and

(iii) Provision for adequate income spread between public unit and nonmember shares and corresponding assets.

(3) A federal credit union seeking an exemption from the limits of paragraph (b)(1) of this section must submit to the Regional Director a written request including:

(i) The new maximum level of public unit and nonmember shares requested, either as a dollar amount or a percentage of total shares;

(ii) The current plan adopted by the credit union's board of directors concerning the use of new public unit and nonmember shares;

(iii) A copy of the credit union's latest financial statement; and

(iv) A copy of the credit union's loan and investment policies.

(4) Where the financial condition and management of the credit union are sound and the credit union's plan for the funds is reasonable, there will be a presumption in favor of granting the request. When granted, exemptions will normally be for a two-year period. The Regional Director will provide a written explanation for an exemption that is granted for a lesser time period.

(5) The Regional Director will provide a written determination on an exemption request within 30 calendar days after receipt of the request. The 30-day period will not begin to run until all necessary information has been submitted to the Regional Director. All denials may be appealed to the NCUA Board in a timely manner. Appeals should be submitted through the Regional Director.

(6) Upon expiration of an exemption, nonmember shares currently in the credit union in excess of the limits established pursuant to (b)(1) of this section will continue to be insured by the National Credit Union Insurance Fund within applicable limits. No new shares in excess of the limits established pursuant to (b)(1) of this section shall be accepted. Existing share certificates in excess of the limits established pursuant to (b)(1) of this section may remain in the credit union only until maturity.

(c) The limitations herein do not apply to accounts maintained in accordance with 701.37 (Treasury Tax and Loan Depositaries; Depositaries and Financial Agents of the Government) and matching funds required by 705.7(b) (Community Development Revolving Loan Program for Credit Unions). Once a loan granted pursuant to Part 705 is repaid, nonmember share deposits accepted to meet the matching requirement are subject to this section.

§ 701.33 Reimbursement, Insurance, and Indemnification of Officials and Employees.

(a) *Official.* An "official" is a person who is or was a member of the board of directors, credit committee or supervisory committee, or other volunteer committee established by the board of directors.

(b) *Compensation.*

(1) Only one board officer, if any, may be compensated as an officer of the board. The bylaws must specify the officer to be compensated, if any, as well as the specific duties of each of the board officers. No other official may receive compensation for performing the duties or responsibilities of the board or committee position to which the person has been elected or appointed.

(2) For purposes of this section, the term "compensation" specifically excludes:

(i) payment (by reimbursement to an official or direct credit union payment to a third party) for reasonable and proper costs incurred by an official in carrying out the responsibilities of the position to which that person has been elected or appointed, if the payment is determined by the board of directors to be necessary or appropriate in order to carry out the official business of the credit union, and is in accordance with written policies and procedures, including documentation requirements, established by the board of directors. Such payments may include the payment of travel costs for officials and one immediate family member per official;

(ii) provision of reasonable health, accident and related types of personal insurance

protection, supplied for officials at the expense of the credit union: *Provided,* that such insurance protection must exclude life insurance; must be limited to areas of risk, including accidental death and dismemberment, to which the official is exposed by reason of carrying out the duties or responsibilities of the official's credit union position; must cease immediately upon the insured person's leaving office, without providing residual benefits other than from pending claims, if any; and

(iii) indemnification and related insurance consistent with paragraph (c) of this Section.

(c) *Indemnification.*

(1) A Federal credit union may indemnify its officials and current and former employees for expenses reasonably incurred in connection with judicial or administrative proceedings to which they are or may become parties by reason of the performance of their official duties.

(2) Indemnification shall be consistent either with the standards applicable to credit unions generally in the state in which the principal or home office of the credit union is located, or with the relevant provisions of the Model Business Corporation Act. A Federal credit union that elects to provide indemnification shall specify whether it will follow the relevant state law or the Model Business Corporation Act. Indemnification and the method of indemnification may be provided for by charter or bylaw amendment, contract or board resolution, consistent with the procedural requirements of the applicable state law or the Model Business Corporation Act, as specified. A charter or bylaw amendment must be approved by the National Credit Union Administration.

(3) A Federal credit union may purchase and maintain insurance on behalf of its officials and employees against any liability asserted against them and expenses incurred by them in their official capacities and arising out of the performance of their official duties to the extent such insurance is permitted by the applicable state law or the Model Business Corporation Act.

§ 701.34 Designation of low-income status; receipt of secondary capital accounts by low-income designated credit unions.

(a) *Designation of low-income status.* (1) Section 107(6) of the Federal Credit Union Act (12 U.S.C. 1757(6)) authorizes federal credit unions serving predominantly low-income members to receive shares, share drafts and share certificates from nonmembers. In order to utilize this authority, a federal credit union must receive a low-income designation from its Regional Director. The designation may be removed by the Regional Director upon notice to the federal credit union if the definitions set forth in paragraphs (a) (2) and (3) of this section are no longer met. Removals may be appealed to the NCUA Board within 60 days. Appeals should be submitted through the Regional Director.

(2) The term "low-income members" shall mean those members who make less than 80 percent of the average for all wage earners as established by the Bureau of Labor Statistics or those members whose annual household income falls at or below 80 percent of the median household income for the nation as established by the Census Bureau or those members otherwise defined as low-income members as determined by order of the NCUA Board.

(i) In documenting its low-income membership, a credit union that serves a geographic area where a majority of residents fall at or below the annual income standard is presumed to be serving predominantly low-income members. In applying the standards, Regional Directors shall make allowances for geographical areas with higher costs of living. The following is the exclusive list of geographic areas with the differentials to be used:

	Percent
Hawaii	40
Alaska	36
Washington, DC	19
Boston	17
San Diego	15
Los Angeles	14
New York	13
San Francisco	13
Seattle	10
Chicago	7
Philadelphia	7

(ii) The term "low-income member" also includes those members who are enrolled as full-time or part-time students in a college, university, high school, or vocational school.

(3) The term "predominantly" is defined as a simple majority.

(b) *Receipt of secondary capital accounts by low-income designated credit unions.* A Federal credit union having a designation of low income status pursuant to paragraph (a) of this section may offer

secondary capital accounts to nonnatural person members and nonnatural person nonmembers on the following conditions:

(1) Prior to offering secondary capital accounts, the credit union shall adopt, and forward to the appropriate NCUA Regional Director, a written plan for use of the funds in the secondary capital accounts and subsequent liquidity needs to meet repayment requirements upon maturity of the accounts.

(2) The secondary capital account must be established as a uninsured secondary capital account or other form of non-share account.

(3) The maturity of the secondary capital account must be for a minimum of five years.

(4) The secondary capital account must not be redeemable prior to maturity.

(5) The secondary capital account shall not be insured by the National Credit Union Share Insurance Fund or any governmental or private entity.

(6) The secondary capital account holder's claim against the credit union must be subordinate to all other claims including those of shareholders, creditors and the National Credit Union Share Insurance Fund.

(7) Funds in the secondary capital account (including both principal and interest) must be available to cover operating losses realized by the credit union that exceed its net available reserves and undivided earnings (i.e., reserves and undivided earnings exclusive of allowance accounts for loan and investment losses), and to the extent funds are so used, the credit union shall under no circumstances restore or replenish the account. Losses shall be distributed pro-rata among all secondary capital accounts held by the credit union at the time the losses are realized.

(8) The secondary capital account may not be pledged or provided by the account-holder as security on a loan or other obligation with the credit union or any other party.

(9) In the event of merger or other voluntary dissolution of the credit union, other than merger into another low-income designated credit union, the secondary capital accounts will, to the extent they are not needed to cover losses at the time of merger or dissolution, be closed and paid out to the account-holder.

(10) A secondary capital account contract agreement must be executed between an authorized representative of the account holder and the credit union accurately establishing the terms and conditions of this section and containing no provisions inconsistent therewith.

(11) A disclosure and acknowledgment as set forth in the Appendix to this section must be provided to and executed by an authorized representative of the secondary capital account holder at the time of entering into the account agreement, and original copies of the account agreement and the disclosure and acknowledgment must be retained by the credit union for the term of the agreement.

(c) *Accounting treatment; weighted value for purposes of recognizing capital value of secondary capital accounts.* (1) A low-income designated credit union that issues secondary capital accounts pursuant to paragraph (b) of this section shall record the funds on its balance sheet in an equity account entitled "uninsured secondary capital account." For such accounts with remaining maturities of less than five years, the credit union shall reflect the capital value of the accounts in its financial statement in accordance with the following scale:

(i) Four to less than five years remaining maturity—80 percent.

(ii) Three to less than four years remaining maturity—60 percent.

(iii) Two to less than three years remaining maturity—40 percent.

(iv) One to less than two years remaining maturity—20 percent.

(v) Less than one year remaining maturity—0 percent.

(2) The credit union will reflect the full amount of the secondary capital on deposit in a footnote to its financial statement.

Appendix to § 701.34

Disclosures and acknowledgment in the following form must be provided to any investor in secondary capital accounts in a low-income designated credit union.

An original, signed copy must be retained by the credit union.

Disclosure and Acknowledgment

I, _____ (name of signatory), hereby acknowledge and agree to the following in my capacity as _____ (official position or title) of _____ (name of institutional investor:

• _____ (name of institutional investor) has committed _____ (amount of funds) to a secondary capital account with _____ (name of credit union).

• The funds committed to the secondary capital account are committed for a period of ____ years and are not redeemable prior to _____.

• The secondary capital account is not a share account and the funds committed to the secondary capital account are not insured by the National Credit Union Share Insurance Fund or any other governmental or private entity.

The funds committed to the secondary capital account and any interest paid to the account may be used by _____ (name of credit union) to cover any and all operating losses that exceed the credit union's net available reserves and undivided earnings exclusive of allowance accounts for loan and investment losses), and in the event the funds are so used _____ (name of credit union) will be under no circumstances restore or replenish those funds to _____ (organization).

• In the event of liquidation of _____ (name of credit union), the funds committed to the secondary capital account shall be *subordinate to all other claims* on the assets of the credit union, including claims of member shareholders, creditors and the National Credit Union Share Insurance Fund.

_____

(Signature)

_____

(Official Title)

§ 701.35 Share, Share Draft, and Share Certificate Accounts.

(a) Federal credit unions may offer share, share draft, and share certificate accounts in accordance with Section 107(6) of the Act (12 U.S.C. § 1757(6)) and the board of directors may declare dividends on such accounts as provided in Section 117 of the Act (12 U.S.C. § 1763).

(b) A Federal credit union shall accurately represent the terms and conditions of its share, share draft, and share certificate accounts in all advertising, disclosures, or agreements, whether written or oral.

(c) A federal credit union may, consistent with this section, parts 707 and 740 of this subchapter, other federal law, and its contractual obligations, determine the types of fees or charges and other matters affecting the opening maintaining and closing of a share, share draft or share certificate account. State laws regulating such activities are not applicable to federal credit unions.

(d) For purposes of this Section, "state law" means the constitution, statutes, regulations, and judicial decisions of any state, the District of Columbia, the several territories and possessions of the United States, and the Commonwealth of Puerto Rico.

§ 701.36 FCU Ownership of Fixed Assets.

(a) *A Federal credit union's ownership in fixed assets shall be limited as described in this chapter.*

(b) *Definitions*—As Used in This Section:

(1) Premises includes any office, branch office, suboffice, service center, parking lot, other facility, or real estate where the credit union transacts or will transact business.

(2) Furniture, Fixtures, and Equipment includes all office furnishings, office machines, computer hardware and software, automated terminals, heating and cooling equipment.

(3) Fixed Assets means premises and furniture, fixtures and equipment as these terms are defined above.

(4) Investments in fixed assets means:

(i) any investment in real property (improved or unimproved) which is being used or is intended to be used as premises;

(ii) any leasehold improvement on premises;

(iii) the aggregate of all capital and operating lease payments pursuant to lease agreements for fixed assets;

(iv) any investment in the bonds, stock, debentures, or other obligations of a partnership or corporation, including any entity described in part 712 holding any fixed assets used by the Federal credit union and any loans to such partnership or corporation; or

(v) any investment in furniture, fixtures and equipment.

(5) Abandoned premises means former Federal credit union premises from the date of relocation to new quarters, and property originally acquired for future expansion for which such use is no longer contemplated.

(6) Immediate family member means a spouse or other family members living in the same household.

(7) Shares mean all savings (regular shares, share drafts, share certificates, other savings) and retained earnings means regular reserve,

reserve for contingencies, supplemental reserves, reserve for losses and undivided earnings.

(8) Senior management employee means the credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President or Assistant Treasurer/Manager) and the chief financial officer (Comptroller).

(c) *Investment in Fixed Assets.*

(1) No Federal credit union with $1,000,000 or more in assets, without the prior approval of the Administration, shall invest in fixed assets if the aggregate of all such investments exceeds 5 percent of shares and retained earnings.

(2) A Federal credit union shall submit such statement and reports as the NCUA regional director may require in support of any investment in fixed assets in excess of the limit specified above.

(3) If the Administration determines that the proposal will not adversely affect the credit union, an aggregate dollar amount or percentage of assets will be approved for investment in fixed assets. Once such a limit has been approved, and unless otherwise specified by the regional director, a Federal credit union may make future acquisitions of fixed assets, provided the aggregate of all such future investments in fixed assets does not exceed an additional 1 percent of the shares and retained earnings of the credit union over the amount approved.

(4) Federal credit unions shall submit their requests to the NCUA regional office having jurisdiction over the geographical area in which the credit union's main office is located. The regional office shall inform the requesting credit union, in writing, of the date the request was received. If the credit union does not receive notification of the action taken on its request within 45 calendar days of the date the request was received by the regional office, the credit union may proceed with its proposed investment in fixed assets.

(d) *Premises.*

(1) When real property is acquired for future expansion, at least partial utilization should be accomplished within a reasonable period, which shall not exceed 3 years unless otherwise approved in writing by the Administration. After real property acquired for future expansion has been held for 1 year, a board resolution with definitive plans for utilization must be available for inspection by an NCUA examiner.

(2) A Federal credit union shall endeavor to dispose of "abandoned premises" at a price sufficient to reimburse the Federal credit union for its investment and costs of acquisition. Current documents must be maintained reflecting the Federal credit union's continuing and diligent efforts to dispose of "abandoned premises." After "abandoned premises" have been on the Federal credit union's books for 4 years, the property must be publicly advertised for sale. Disposition must occur through public or private sale within 5 years of abandonment, unless otherwise approved in writing by the Administration.

(e) *Prohibited Transactions.*

(1) With the exception of a short-term informal lease agreement (maturity less than 1 year) no Federal credit union may acquire or lease premises without the prior written approval of the Administration from any of the following:

(i) a director, member of the credit committee or supervisory committee, or senior management employee of the Federal credit union, or im-mediate family member of any such individual.

(ii) a corporation in which any director, member of the credit committee or supervisory committee, official, or senior management employee, or immediate family members of any such individual, is an officer or director, or has a stock interest of 10 percent or more.

(iii) a partnership in which any director, member of the credit committee or supervisory committee, or senior management employee, or immediate family members of any such individual, is a general partner, or a limited partner with an interest of 10 percent or more.

(2) The prohibition contained in paragraph (e)(1) also applies to any employee not otherwise covered if the employee is directly involved in investments in fixed assets unless the board of directors determines that the employee's involvement does not present a conflict of interest.

(3) All transactions with business associates or family members not specifically prohibited by this subsection (e) must be conducted at arm's length and in the interest of the credit union.

§ 701.37 Treasury Tax and Loan Depositaries; Depositaries and Financial Agents of the Government.

(a) *Definitions.*

(1) "Treasury Tax and Loan ("TT&L") Remittance Account" means a nondividend-paying account, the balance of which is subject to the right of immediate withdrawal, established for receipt of payments of Federal taxes and certain United States obligations under United States Treasury Department regulations.

(2) "TT&L Note Account" means an account subject to the right of immediate call, evidencing funds held by depositaries electing the note option under United States Treasury Department regulations.

(3) "Treasury General Account" means an account, established under United States Treasury Department regulations, in which a zero balance may be maintained and from which the entire balance may be withdrawn by the depositor immediately under all circumstances except closure of the credit union;

(4) "U.S. Treasury Time Deposit-Open Account" means a nondividend-bearing account, established under United States Treasury Department regulations, which generally may not be withdrawn until the expiration of 14 days after the date of the United States Treasury Department's written notice of intent to withdraw.

(b) Subject to regulation of the United States Treasury Department, a Federal credit union may serve as a Treasury tax and loan depositary, a depositary of Federal taxes, a depositary of public money, and a financial agent of the United States Government. In serving in these capacities, a Federal credit union may maintain the accounts defined in subsection (a), pledge collateral, and perform the services described under United States Treasury Department regulations for institutions acting in these capacities.

(c) Funds held in a TT&L Remittance Account, a TT&L Note Account, a Treasury General Account, and a U.S. Treasury Time Deposit-Open Account shall be considered deposits of public funds. Funds held in a TT&L Remittance Account and a TT&L Note Account shall be added together and insured up to a maximum of $100,000 in the aggregate. Funds held in a Treasury General Account and a U.S. Treasury Time Deposit-Open Account shall be added together and insured up to a maximum of $100,000 in the aggregate.

(d) Funds held in a TT&L Remittance Account, a TT&L Note Account, a Treasury General Account, and U.S. Treasury Time Deposit-Open Account are not subject to the 60-day notice requirement of Article III, section 5(a) of the Federal Credit Union Bylaws.

§ 701.38 Borrowed Funds From Natural Persons.

(a) Federal credit unions may borrow from a natural person, PROVIDED:

(1) The borrowing is evidenced by a signed promissory note which sets forth the terms and conditions regarding maturity, prepayment, interest rate, method of computation, and method of payment;

(2) The promissory note and any advertisement for such funds contains conspicuous language indicating that:

(i) the note represents money borrowed by the credit union;

(ii) the note does not represent shares and, therefore, is not insured by the National Credit Union Share Insurance Fund.

Part 722

Appraisals

§ 722.1 Authority, Purpose, and Scope.

(a) *Authority.* Part 722 is issued by the National Credit Union Administration ("NCUA") under Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") (Pub. L. No. 101–73, 103 Stat. 183, 1989) and 12 U.S.C. 1757 and 1766.

(b) *Purpose and Scope.* (1) Title XI provides protection for federal financial and public policy interests in real estate-related transactions by requiring real estate appraisals used in connection with federally related transactions to be performed in writing, in accordance with uniform standards, by appraisers whose competency has been demonstrated and whose professional conduct will be subject to effective supervision. This Part implements the requirements of Title XI and applies to all federally related transactions entered into by the National Credit Union Administration or by federally insured credit unions ("regulated institutions").

(2) This Part:

(i) identifies which real estate-related financial transactions require the services of an appraiser;

(ii) prescribes which categories of federally related transactions shall he appraised by a state-certified appraiser and which by a state-licensed appraiser; and

(iii) prescribes minimum standards for the performance of real estate appraisals in connection with federally related transactions under the jurisdiction of the National Credit Union Administration.

§ 722.2 Definitions.

(a) "Appraisal" means a written statement independently and impartially prepared by a qualified appraiser setting forth an opinion as to the market value of an adequately-described property as of a specific date(s), supported by the presentation and analysis of relevant market information.

(b) "Appraisal Foundation" means the Appraisal Foundation established on November 30, 1987, as a not-for-profit corporation under the laws of Illinois.

(c) "Appraisal Subcommittee" means the Appraisal Subcommittee of the Federal Financial Institutions Examination Council.

(d) "Complex 1-to-4 family residential property appraisal" means one in which the property to be appraised, the form of ownership, or market conditions are atypical.

(e) "Federally related transaction" means any real estate-related financial transaction entered into on or after August 9, 1990, that:

(1) the National Credit Union Administration, or any federally insured credit union, engages in or contracts for; and

(2) requires the services of an appraiser.

(f) "Market value" means the most probable price which a property should bring in a competitive and open market under all conditionsrequisite to a fair sale, the buyer and seller each acting prudently and knowledgeably and as suming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

(1) buyer and seller are typically motivated;

(2) both parties are well informed or well advised, and acting in what they consider their own best interests;

(3) a reasonable time is allowed for exposure in the open market;

(4) payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and

(5) the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

(g) "Real estate or real property" means an identified parcel or tract of land, including easements, rights of way, undivided or future interests and similar rights in a parcel or tract of land, but does not include mineral rights, timber rights, and growing crops, water rights and similar interests severable from the land when the transaction does not involve the associated parcel or tract of land.

(h) "Real estate-related financial transaction" means any transaction involving:

(1) the sale, lease, purchase, investment in or exchange of real property, including interests in property, or the financing thereof; or

(2) the refinancing of real property or interests in real property; or

(3) the use of real property or interests in property as security for a loan or investment, including mortgage-backed securities.

(i) "State-certified appraiser" means any individual who has satisfied the requirements for certification in a state or territory whose criteria for certification as a real estate appraiser currently meet the minimum criteria for certification issued by the Appraiser Qualification Board of the Appraisal Foundation. No individual shall be a state-certified appraiser unless such individual has achieved a passing grade upon a suitable examination administered by a state or territory that is consistent with and equivalent to the Uniform State Certification Examination issued or endorsed by the Appraiser Qualification Board. In addition, the Appraisal Subcommittee must not have issued a finding that the policies, practices, or procedures of a state or territory are inconsistent with Title XI of FIRREA. The National Credit Union Administration may, from time to time, impose additional qualification criteria for certified appraisers performing appraisals in connection with federally related transactions within its jurisdiction.

(j) "State-licensed appraiser" means any individual who has satisfied the requirements for licensing in a state or territory where the licensing procedures comply with Title XI of FIRREA and where the Appraisal Subcommittee has not issued a finding that the policies, practices, or procedures of the state or territory are inconsistent with Title XI. The NCUA may, from time to time, impose additional qualification criteria for licensed appraisers performing appraisals in connection with federally related transactions within its jurisdiction.

(k) "Tract development" means a project of five units or more that is constructed or is to be constructed as a single development.

(l) "Transaction value" means:

(1) for loans or other extensions of credit, the amount of the loan or extension of credit;

(2) for sales, leases, purchases, and investments in or exchanges of real property, the market value of the real property interest involved; and

(3) for the pooling of loans or interests in real property for resale or purchase, the amount of the loan or market value of the real property calculated with respect to each such loan or interest in real property.

§ 722.3 Appraisals required; transactions requiring a State certified or licensed appraiser.

(a) *Appraisals required.* An appraisal performed by a State certified or licensed appraiser is required for all real estate-related financial transactions except those in which:

(1) The transaction value is $100,000 or less except if it is a business loan and then the transaction value is $50,000 or less;

(2) A lien on real property has been taken as collateral through an abundance of caution and where the terms of the transaction as a consequence have not been made more favorable than they would have been in the absence of a lien;

(3) A lien on real estate has been taken for purposes other than the real estate's value;

(4) A lease of real estate is entered into, unless the lease is the economic equivalent of a purchase or sale of the leased real estate;

(5) The transaction involves an existing extension of credit at the credit union, provided that:

(i) There is no advancement of new monies, other than funds necessary to cover reasonable closing costs; and

(ii) There has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the credit union's real estate collateral protection after the transaction;

(6) The transaction involves the purchase, sale, investment in, exchange of, or extension of credit secured by, a loan or interest in a loan, pooled loans, or interests in real property, including mortgage-backed securities, and each loan or interest in a loan, pooled loan, or real property interest met the requirements of this regulation, if applicable, at the time of origination;

(7) The transaction is wholly or partially insured or guaranteed by a United States government agency or United States government sponsored agency;

(8) The transaction either:

(i) Qualifies for sale to a United States government agency or United States government sponsored agency; or

(ii) Involves a residential real estate transaction in which the appraisal conforms to the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation appraisal standards applicable to that category of real estate; or

(9) The regional director has granted a waiver from the appraisal requirement for a category of loans meeting the definition of a member business loan.

(b) *Transactions Requiring a State-Certified Appraiser.*

(1) (All transactions of $1,000,000 or more) All federally related transactions having a transaction value of $1,000,000 or more shall require an appraisal prepared by a state-certified appraiser.

(2) (Nonresidential transactions) All federally related transactions having a transaction value of more than $50,000, other than those involving appraisals of 1-to-4 family residential properties, shall require an appraisal prepared by a state-certified appraiser.

(3) (Complex residential transactions of $250,000 or more) All complex 1-to-4 family residential property appraisals rendered in connection with federally related transactions shall require a state-certified appraiser if the transaction value is $250,000 or more. A regulated institution may presume that appraisals of 1-to-4 family residential properties are not complex unless the institution has readily available information that a given appraisal will be complex. The regulated institution shall be responsible for making the final determination of whether the appraisal is complex. If, during the course of the appraisal, a licensed appraiser identifies factors that would result in the property, form of ownership, or market conditions being considered atypical, then either:

(i) the regulated institution may ask the licensed appraiser to complete the appraisal and have a certified appraiser approve and cosign the appraisal; or

(ii) the institution may engage a certified appraiser to complete the appraisal.

(c) *Transactions Requiring Either a State-Certified or -Licensed Appraiser.* All appraisals for federally related transactions not requiring the services of a state-certified appraiser shall be prepared by either a state-certified appraiser or a state-licensed appraiser.

(d) *Valuation requirement.* Secured transactions exempted from appraisal requirements pursuant to paragraphs (a)(1) and (a)(5) of this section and not otherwise exempted from this regulation or fully insured shall be supported by a written estimate of market value, as defined in this part, performed by an individual having no direct or indirect interest in the property, and qualified and experienced to perform such estimates of value for the type and amount of credit being considered.

(e) *Appraisals to address safety and soundness concerns.* NCUA reserves the right to require an appraisal under this part whenever the agency believes it is necessary to address safety and soundness concerns.

§ 722.4 Minimum appraisal standards.

For federally related transactions, all appraisals shall, at a minimum:

(a) Conform to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board of the Appraisal Foundation, 1029 Vermont Ave., NW., Washington, DC 20005;

(b) Be written and contain sufficient information and analysis to support the institution's decision to engage in the transaction;

(c) Analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased buildings, non-market lease terms, and tract developments with unsold units;

(d) Be based upon the definition of market value as set forth in § 722.2(f); and

(e) Be performed by State licensed or certified appraisers in accordance with requirements set forth in this part.

§ 722.5 Appraiser Independence.

(a) *Staff Appraiser.* If an appraisal is prepared by a staff appraiser, that appraiser must be independent of the lending, investment, and collection functions and not involved, except as an appraiser, in the federally related transaction, and have no direct or indirect interest, financial or otherwise, in the property. If the only qualified persons available to perform an appraisal are involved in the lending, investment, or collection functions of the credit union, the credit union shall take appropriate steps to ensure that the appraisers exercise independent judgment. Such steps include, but are not limited to, prohibiting an individual from performing an appraisal in connection with feder-

ally related transactions in which the appraiser is otherwise involved.

(b) *Fee Appraisers.* (1) If an appraisal is prepared by a fee appraiser, the appraiser shall be engaged directly by the credit union or its agent and have no direct or indirect interest, financial or otherwise, in the property or the transaction.

(2) A credit union also may accept an appraisal that was prepared by an appraiser engaged directly by another financial services institution; if:

(i) the appraiser has no direct or indirect interest, financial or otherwise, in the property or transaction; and

(ii) the credit union determines that the appraisal conforms to the requirement of this part and is otherwise acceptable.

§ 722.6 Professional Association Membership; Competency.

(a) *Membership in Appraisal Organization.* A state-certified appraiser or a state-licensed appraiser may not be excluded from consideration for an assignment for a federally related transaction solely by virtue of membership or lack of membership in any particular appraisal organization.

(b) *Competency.* All staff and fee appraisers performing appraisals in connection with federally related transactions must be state-certified or -licensed as appropriate. However, a state-certified or -licensed appraiser may not be considered competent solely by virtue of being certified or licensed. Any determination of competency shall be based upon the individual's experience and educational background as they relate to the particular appraisal assignment for which he or she is being considered.

§ 722.7 Enforcement.

Credit unions and institution-affiliated parties, including staff appraisers, may be subject to removal and/or prohibition orders, cease-and-desist orders, and the imposition of civil money penalties pursuant to Section 1786 of the Federal Credit Union Act, or any other applicable law.

Part 723

Member Business Loans

§ 723.1 What is a member business loan?

(a) *General rule.* A member business loan includes any loan, line of credit, or letter of credit where the borrower uses the proceeds for the following purposes:

(1) Commercial;

(2) Corporate;

(3) Other business investment property or venture; or

(4) Agricultural.

(b) *Exceptions to the general rule.* The following is not a member business loan:

(1) A loan fully secured by a lien on a 1 to 4 family dwelling that is the member's primary residence;

(2) A loan fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions;

(3) Loan(s) to a member or an associated member which, when added together, are equal to or less than $50,000;

(4) A loan where a federal or state agency (or its political subdivision) fully insures repayment, or fully guarantees repayment, or provides an advance commitment to purchase in full; or

(5) A loan granted by a corporate credit union to another credit union under part 704 of this chapter.

§ 723.2 What are the prohibited activities?

(a) Who is ineligible to receive a member business loan? You must not make a member business loan to the following:

(1) Any member of the board of directors who is compensated as such;

(2) Your chief executive officer (typically this individual holds the title of President or Treasurer/Manager);

(3) Any assistant chief executive officers (e.g., Assistant President, Vice President, or Assistant Treasurer/Manager);

(4) Your chief financial officer (Comptroller); or

(5) Any associated member or immediate family member of anyone listed in paragraphs (a)(1) through (4) of this section.

(b) Equity agreements/joint ventures. You may not grant a member business loan if any additional income received by the credit union, senior management employees, or any member of the board of directors who is compensated as such, is tied to the profit or sale of the business or commercial endeavor for which the loan is made.

§ 723.3 What are the requirements for construction and development lending?

Unless the Regional Director grants an exemption, loans granted for the construction or development of commercial or residential property are subject to the following additional requirements.

(a) The aggregate of all construction and development loans must not exceed 15% of reserves, (excluding the Allowance for Loan Losses account). To determine the aggregate, you may exclude any portion of a loan:

(1) Secured by shares in the credit union;

(2) Secured by deposits in another federally insured financial institution;

(3) Fully or partially insured or guaranteed by any agency of the federal government, state, or its political subdivisions; or

(4) Subject to an advance commitment to purchase by any agency of the federal government, state, or its political subdivisions;

(b) The borrower must have a minimum of 35% equity interest in the project being financed; and

(c) The funds may be released only after on-site, written inspections by independent, qualified personnel and according to a preapproved draw schedule and any other conditions as set forth in the loan documentation.

§ 723.4 What are the other applicable regulations?

The provisions of § 701.21(a) through (g) of this chapter apply to member business loans to the extent they are consistent with this part.

§ 723.5 How do you implement a member business loan program?

The board of directors must adopt specific business loan policies and review them at least annually. The board must also utilize the services of an individual with at least two years direct experience with the type of lending the credit union will be engaging in. Credit unions do not have to hire staff to meet the requirements of this section; however, credit unions must ensure that the expertise is available. A credit union can meet the experience requirement through various approaches. For example, a credit union can use the services of a credit union service organization, an employee of another credit union, an independent contractor, or other third parties. However, the actual decision to grant a loan must reside with the credit union.

§ 723.6 What must your member business loan policy address?

At a minimum, your policy must address the following:

(a) The types of business loans you will make;

(b) Your trade area;

(c) The maximum amount of your assets, in relation to reserves, that you will invest in business loans;

(d) The maximum amount of your assets, in relation to reserves, that you will invest in a given category or type of business loan;

(e) The maximum amount of your assets, in relation to reserves, that you will loan to any one member or group of associated members, subject to § 723.8;

(f) The qualifications and experience of personnel (minimum of 2 years) involved in making and administering business loans;

(g) A requirement to analyze and document the ability of the borrower to repay the loan;

(h) Receipt and periodic updating of financial statements and other documentation, including tax returns;

(i) A requirement for sufficient documentation supporting each request to extend credit, or increase an existing loan or line of credit (except where the board of directors finds that the documentation requirements are not generally available for a particular type of business loan and states the reasons for those findings in the credit union's written policies). At a minimum, your documentation must include the following:

(1) Balance sheet;

(2) Cash flow analysis;

(3) Income statement;

(4) Tax data;

(5) Analysis of leveraging; and

(6) Comparison with industry average or similar analysis.

(j) The collateral requirements must include:

(1) Loan-to-value ratios;

(2) Determination of value;

(3) Determination of ownership;

(4) Steps to secure various types of collateral; and

(5) How often the credit union will reevaluate the value and marketability of collateral;

(k) The interest rates and maturities of business loans;

(l) General loan procedures which include:

(1) Loan monitoring;

(2) Servicing and follow-up; and

(3) Collection;

(m) Identification of those individuals prohibited from receiving member business loans.

§ 723.7 What are the collateral and security requirements?

(a) Unless your Regional Director grants a waiver, all member business loans must be secured by collateral as follows:

Lien	Minimum loan to value requirements
All	LTV ratios cannot exceed 95%.
First	You may grant a LTV ratio in excess of 80% only where the value in excess of 80% is covered through: for real estate member business loans, acquisition of private mortgage or equivalent type insurance provided by an insurer acceptable to the credit union (where available); insurance or guarantees by, or subject to advance commitment to purchase by, an agency of the federal government; or insurance or guarantees by, or subject to advance commitment to purchase by, an agency of a state or any of its political subdivisions.
First	LTV ratios up to 80%.
Second	LTV ratios up to 80%.

(b) Borrowers, other than a not for profit organization as defined by the Internal Revenue Service Code (26 U.S.C. 501) or those where the Regional Director grants a waiver, must provide their personal liability and guarantee.

(c) Federally insured credit unions are exempt from the provisions of paragraphs (a) and (b) of this section with respect to credit card line of credit programs offered to nonnatural person members that are limited to routine purposes normally made available under those programs.

§ 723.8 How much may one member, or a group of associated members, borrow?

The aggregate amount of outstanding member business loans (including any unfunded commitments) to any one member or group of associated members must not exceed the greater of:

(a) 15% of the credit union's reserves (excluding the Allowance for Loan Losses account); or

(b) $100,000; or

(c) An amount approved by the credit union's Regional Director.

§ 723.9 How do you calculate the aggregate 15% limit?

(a) *Step 1.* Calculate the numerator by adding together the total outstanding balance of member business loans to any one member, or group of associated members. From this amount, subtract any portion:

(1) Secured by shares in the credit union;

(2) Secured by deposits in another federally insured financial institution;

(3) Fully or partially insured or guaranteed by any agency of the Federal government, state, or its political subdivisions;

(4) Subject to an advance commitment to purchase by any agency of the Federal government, state, or its political subdivisions.

(b) *Step 2.* Divide the numerator by all reserves, excluding the Allowance for Loan Losses account.

§ 723.10 What loan limit waivers are available?

In addition to an individual waiver from the personal liability and guarantee requirement, you also may seek a waiver for a category of loans in the following areas:

(a) Loan-to-value ratios;

(b) Maximum loan amount to one borrower or associated group of borrowers; and

(c) Construction and development loan limits.

§ 723.11 How do you obtain a waiver?

To obtain a waiver, a federal credit union must submit a request to the Regional Director. A state chartered federally insured credit union must submit the request to its state supervisory authority. If the state supervisory authority approves the request, the state regulator will forward the request to the Regional Director. A waiver is not effective until it is approved by the Regional Director. The waiver request must contain the following:

(a) A copy of your business lending policy;

(b) The higher limit sought;

(c) An explanation of the need to raise the limit;

(d) Documentation supporting your ability to manage this activity; and

(e) An analysis of the credit union's prior experience making member business loans, including as a minimum:

(1) The history of loan losses and loan delinquency;

(2) Volume and cyclical or seasonal patterns;

(3) Diversification;

(4) Concentrations of credit to one borrower or group of associated borrowers in excess of 15% of reserves (excluding the Allowance for Loan Losses account);

(5) Underwriting standards and practices;

(6) Types of loans grouped by purpose and collateral; and

(7) The qualifications of personnel responsible for underwriting and administering member business loans.

§ 723.12 What will NCUA do with my waiver request?

Your Regional Director will:

(a) Review the information you provided in your request;

(b) Evaluate the level of risk to your credit union;

(c) Consider your credit union's historical CAMEL composite and component ratings when evaluating your request; and

(d) Notify you of the action taken within 45 calendar days of receiving the request from the fed-

eral credit union or the state supervisory authority. If you do not receive notification within 45 calendar days of the date the request was received by the regional office, the credit union may assume approval of the waiver request.

§ 723.13 What options are available if the NCUA Regional Director denies our waiver request, or a portion of it?

You may appeal the Regional Director's decision in writing to the NCUA Board. Your appeal must include all information requested in § 723.11 and why you disagree with your Regional Director's decision.

§ 723.14 How do I reserve for potential losses?

Non-delinquent loans may be classified based on factors such as the adequacy of analysis and supporting documentation. You must classify potential loss loans as either substandard, doubtful, or loss. The criteria for determining the classification of loans are:

(a) *Substandard.* Loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of debt. They are characterized by the distinct possibility that the credit union will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard.

(b) *Doubtful.* A loan classified doubtful has all the weaknesses inherent in one classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include: proposed merger, acquisition, or liquidation actions; capital injection; perfecting liens on collateral; and refinancing plans.

(c) *Loss.* Loans classified loss are considered uncollectible and of such little value that their continuance as loans is not warranted. This classification does not necessarily mean that the loan has absolutely no recovery or salvage value, but rather, it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may occur in the future.

§ 723.15 How much must I reserve for potential losses?

The following schedule sets the minimum amount you must reserve for classified loans:

Classification	Amount required
Substandard	10% of outstanding amount unless other factors (for example, history of such loans at the credit union) indicate a greater or lesser amount is appropriate.
Doubtful	50% of the outstanding amount.
Loss	100% of the outstanding amount.

§ 723.16 What is the aggregate member business loan limit for a credit union?

The aggregate limit on a credit union's outstanding member business loans (including any unfunded commitments) is the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets. Net worth is all of the credit union's retained earnings. Retained earnings normally includes undivided earnings, regular reserves and any other reserves.

§ 723.17 Are there any exceptions to the aggregate loan limit?

There are three circumstances where a credit union may qualify for an exception from the aggregate limit. The three exceptions are:

(a) Credit unions that have a low-income designation or participate in the Community Development Financial Institutions program;

(b) Credit unions that were chartered for the purpose of primarily making member business loans and can provide documentary evidence; or

(c) Credit unions that have a history of primarily making member business loans, meaning that either member business loans comprise at least 25% of the credit union's outstanding loans (as evidenced in a call report for 1998 or any of the three

prior years) or member business loans comprise the largest portion of the credit union's loan portfolio. For example, if a credit union makes 23% member business loans, 22% first mortgage loans, 22% new automobile loans, 20% credit card loans, and 13% total other real estate loans, then the credit union meets this exception.

§ 723.18 How do I obtain an exception?

To obtain the exception, a federal credit union must submit documentation to the Regional Director, demonstrating that it meets the criteria of one of the exceptions. A state chartered federally insured credit union must submit documentation to its state regulator. The state regulator should forward its decision to NCUA. The exception does not expire unless revoked by the state regulator for a state chartered federally insured credit union or the Regional Director for a federal credit union. If an exception request is denied for a federal credit union, it may be appealed to the NCUA Board within 60 days of the denial by the Regional Director. Until the NCUA Board acts on the appeal, the credit union can continue to make new business loans

§ 723.19 What are the recordkeeping requirements?

You must separately identify member business loans in your records and in the aggregate on your financial reports.

§ 723.20 How can a state supervisory authority develop and enforce a member business loan regulation?

(a) The NCUA Board may exempt a federally insured state chartered credit union from NCUA's member business loan rule, if, NCUA approves the state's rule for use for state chartered federally insured credit unions. In making this substantial equivalency determination, the Board is guided by safety and soundness considerations and reviews whether the state regulation minimizes the risk and accomplishes the overall objectives of NCUA's member business rule in this part. Specifically, the Board will focus its review on the definition of:

(1) A member business loan;

(2) Loan to one borrower limits;

(3) Written loan policies;

(4) Collateral and security requirements;

(5) Construction and development lending; and

(6) Loans to senior management.

(b) To receive NCUA's approval of a state's members business rule, the state supervisory authority must submit its rule to the NCUA regional office. After reviewing the rule, the region will forward the request to the NCUA Board for a final determination.

§ 723.21 Definitions.

For purposes of this part, the following definitions apply:

Associated member is any member with a shared ownership, investment, or other pecuniary interest in a business or commercial endeavor with the borrower.

Construction or development loan is a financing arrangement for acquiring property or rights to property, including land or structures, with the intent to convert it to income-producing property such as residential housing for rental or sale; commercial use; industrial use; or similar uses.

Immediate family member is a spouse or other family member living in the same household.

Loan-to-value ratio is the aggregate amount of all sums borrowed, outstanding balances plus any unfunded commitment or line of credit, from all sources on an item of collateral divided by the market value of the collateral used to secure the loan.

Reserves are all reserves, including the Allowance for Loan Losses and Undivided Earnings or surplus.

(b) Approval is not required for:

(1) Purchases of student loans or real estate secured loans to facilitate the packaging of a pool of loans to be sold or pledged on the secondary market under § 701.23(b)(1) (iii) or (iv) of this chapter or comparable state law for state-chartered credit unions, or purchases of member loans under § 701.23(b)(1)(i) of this chapter or comparable state law for state-chartered credit unions; or

(2) Assumptions or receipt of deposits, shares or liabilities as rollovers or transfers of member retirement accounts or in which an NCUSIF-insured credit union perfects a security interest in connection with an extension of credit to any member.

§ 741.9 Uninsured membership shares.

Any credit union that is insured pursuant to Title II of the Act may not offer membership shares that, due to the terms and conditions of the account, are not eligible for insurance coverage. This prohibition does not apply to shares that are uninsured solely because the amount is in excess of the maximum insurance coverage provided pursuant to part 745 of this chapter.

§ 741.10 Disclosure of share insurance.

Any credit union which is insured pursuant to Title II of the Act and is permitted by state law to accept nonmember shares or deposits from sources other than other credit unions and public units (or, for low-income designated credit unions, any nonmembers), shall identify such nonmember accounts as nonmember shares or deposits on any statement or report required by the NCUA Board for insurance purposes. Immediately after a state-chartered credit union receives notice from NCUA that its member accounts are federally insured, the credit union shall advise any present nonmember share and deposit holders by letter that their accounts are not insured by the NCUSIF. Also, future nonmember share and deposit fund holders will be so advised by letter as they open accounts.

Subpart B—Regulations Codified Elsewhere in NCUA's Regulations as Applying to Federal Credit Unions That Also Apply to Federally Insured State-Chartered Credit Unions

§ 741.201 Minimum fidelity bond requirements.

(a) Any credit union which makes application for insurance of its accounts pursuant to Title II of the Act must possess the minimum fidelity bond coverage stated in § 701.20 of this chapter in order for its application for such insurance to be approved and for such insurance coverage to continue. A federally insured credit union whose fidelity bond coverage is terminated shall mail notice of such termination to the Regional Director not less than 35 days prior to the effective date of such termination.

(b) Corporate credit unions must comply with § 704.17 of this chapter in lieu of § 701.20 of this chapter.

§ 741.202 Audit and verification requirements.

(a) The supervisory committee of each credit union insured pursuant to Title II of the Act shall make or cause to be made an audit of the credit union at least once every calendar year covering the period elapsed since the last audit. The audit must fully meet the requirements set forth in §§ 701.12 and 701.13 of this chapter.

(b) Each credit union which is insured pursuant to Title II of the Act shall verify or cause to be verified, under controlled conditions, all passbooks and accounts with the records of the financial officer not less frequently than once every 2 years. The verification must fully meet the requirements set forth in §§ 701.12(e) and 701.13 of this chapter.

§ 741.203 Minimum loan policy requirements.

Any credit union which is insured pursuant to Title II of the Act must:

(a) Adhere to the requirements stated in part 723 of this chapter concerning member business loans, § 701.21(c)(8) of this chapter concerning prohibited fees, and § 701.21(d)(5) of this chapter concerning nonpreferential loans. State-chartered, NCUSIF-insured credit unions in a given state are exempt from these requirements if the state regulatory authority for that state adopts substantially equivalent regulations as determined by the NCUA Board. In nonexempt states, all required NCUA reviews and approvals will be handled in coordination with the state credit union supervisory authority; and

(b) Adhere to the requirements stated in part 722 of this chapter concerning appraisals.

§ 741.204 Maximum public unit and nonmember accounts, and low-income designation.

Any credit union that is insured, or that makes application for insurance, pursuant to Title II of the Act must:

(a) Adhere to the requirements of § 701.32 of this chapter regarding public unit and nonmember accounts, provided it has the authority to accept such accounts. Requests by federally insured state-chartered credit unions for an exemption from the limitation of § 701.32 of this chapter will be made and reviewed on the same basis as that provided in § 701.32 of this chapter for federal credit unions, provided, however that NCUA will not grant an exemption without the concurrence of the appropriate state regulator.

(b) Obtain a low-income designation in order to accept nonmember accounts, other than from public units or other credit unions, provided it has the authority to accept such accounts under state law. The state regulator shall make the low-income designation with the concurrence of the appropriate regional director. The designation will be made and reviewed by the state regulator on the same basis as that provided in § 701.34(a) of this chapter for federal credit unions. Removal of the designation by the state regulator for such credit unions shall be with the concurrence of NCUA.

(c) Receive secondary capital accounts only if the credit has a low-income designation pursuant to paragraph (b) of this section, and then only in accordance with the terms and conditions authorized for Federal credit unions pursuant to § 701.34 of this chapter and to the extent not inconsistent with applicable state law and regulation. State chartered federally insured credit unions offering secondary capital accounts must submit the plan required by § 701.34 to both the state supervisory authority and the NCUA Regional Director.

§ 741.205 Reporting requirements for credit unions that are newly chartered or in troubled condition.

Any federally insured credit union chartered for less than 2 years or any credit union defined to be in troubled condition as set forth in § 701.14(b)(3) of this chapter must adhere to the requirements stated in § 701.14(c) of this chapter concerning the prior notice and NCUA review. Federally insured state-chartered credit unions must submit required information to both the appropriate NCUA Regional Director and their state supervisor. NCUA will consult with the state supervisor before making its determination pursuant to § 701.14 (d)(2) and (f) of this chapter. NCUA will notify the state supervisor of its approval/disapproval no later than the time that it notifies the affected individual pursuant to § 701.14(d)(1) of this chapter.

§ 741.206 Corporate credit unions.

Any corporate credit union insured pursuant to Title II of the Act shall adhere to the requirements of part 704 of this chapter.

§ 741.207 Community development revolving loan program for credit unions.

Any credit union which is insured pursuant to Title II of the Act and is a "participating credit union," as defined in § 705.3 of this chapter, shall adhere to the requirements stated in part 705 of this chapter.

§ 741.208 Mergers of federally insured credit unions: voluntary termination or conversion of insured status.

Any credit union which is insured pursuant to Title II of the Act and which merges with another credit union or non-credit union institution, and any state-chartered credit union which volun-

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 701, 722, 723 and 741

Organization and Operation of Federal Credit Unions; Appraisals; Member Business Loans; and Requirements for Insurance

AGENCY: National Credit Union Administration (NCUA).

ACTION: Interim final rule with request for comments.

SUMMARY: The NCUA is updating, clarifying and streamlining its existing rules concerning member business loans and appraisals for federally insured credit unions, as well as implementing recent statutory limitations regarding member business loans. The intended effect of this rule is to reduce regulatory burden, maintain safety and soundness, and provide an exception for qualifying credit unions from the statutory aggregate limit on a credit union's outstanding member business loans.

DATES: Effective September 29, 1998. Comments must be received on or before November 30, 1998.

ADDRESSES: Direct comments to Becky Baker, Secretary of the Board. Mail or hand-deliver comments to National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428. Fax comments to (703) 518–6319. *Please send comments by one method only.*

FOR FURTHER INFORMATION CONTACT: Michael J. McKenna, Staff Attorney, Office of General Counsel at the above address or telephone: (703) 518–6540; or David Marquis, Director, Office of Examination and Insurance, at the above address or telephone: (703) 518–6360.

SUPPLEMENTARY INFORMATION:

A. Background

The NCUA Board adopted its first member business loan rule in April 1987 due to the increased amount of credit union losses attributed to business lending activity. In response to continued losses to credit unions and the National Credit Union Share Insurance Fund (NCUSIF) due to member business loans, the NCUA Board adopted a more restrictive member business loan rule in September 1991. In general, the results of the 1991 revision have been very positive. Nonetheless, experience with the regulation indicated a need for simplification, clarification, and improvement. Therefore, on July 23, 1997, the Board issued proposed amendments to the regulation governing member business loans (Current Section 701.21(h) and Proposed Part 723 of NCUA's Regulations) and appraisals (Part 722 of NCUA's Regulations) with a sixty-day comment period. 62 FR 41313 (August 1, 1997).

The NCUA Board was considering adopting a final member business loan rule in March of this year, when it became apparent that Congress was considering legislation regarding the ability of credit unions to grant member business loans. The NCUA Board decided to defer consideration of a final rule until Congress had acted on this legislation. Since then, the Credit Union Membership Access Act (the Act) was enacted into law on August 7, 1998. Public Law 105–219. Among other things, the Act imposes a new aggregate limit on a credit union's outstanding member business loans. However, the Act also provides for three circumstances where a credit union may qualify for an exception from the aggregate limit.

The NCUA Board has decided to finalize those aspects of the proposed rule that are not affected by the Act, as well as set forth the procedures for obtaining an exception from the aggregate limit as provided for by the Act. The Board is issuing this rule as an interim final rule because there is no public interest in delaying action on exceptions from the aggregate limit. On the contrary, there is a strong public interest in permitting credit unions to continue to grant, and members to receive, business loans. Therefore, the Board finds it necessary and appropriate to act expeditiously to allow certain credit unions to obtain an exception to continue to grant business loans that would exceed the aggregate loan limit. If this rule is not effective immediately, a number of credit unions and their members could be adversely impacted. Accordingly the Board, for good cause, finds that (1) pursuant to 5 U.S.C. 553(b)(3)(B), notice and public procedures are impracticable, unnecessary, and contrary to the public interest; and (2) pursuant to 5 U.S.C. 553(d)(3), the rule shall be effective immediately and without 30 days advance notice of publication. Although this rule is being issued as an interim final rule and is effective immediately, the NCUA Board encourages interested parties to submit comments, especially on the exception from the aggregate loan limits.

B. Previous Comments and New Statutory Provisions

Thirty-four comments were received. Comments were received from eight federal credit unions, seven state chartered credit unions, ten state leagues, three national credit union trade associations, one bank, four bank trade associations, and one consulting group. Except for the bank and bank trade associations, the commenters were very supportive of the proposal, although most commenters suggested ways to improve the final rule. Two commenters expressed complete support for the proposal.

Section-by-Section Analysis

The proposed amendments were written in a plain English question and answer format. Eight commenters approved of the plain English format but some of these commenters questioned whether a question and answer format would be comprehensive. The commenters expressing doubt requested an additional section of supplementary information.

Four commenters opposed the plain English question and answer format. They believe that using it is not in the best interest of the credit union industry because this format is not comprehensive and would limit the creativity of credit unions in providing business loans to their members. These commenters recommend that the regulation be written in the traditional regulatory style and be supplemented with questions and answers for further clarification of the rule.

The NCUA Board has not received any evidence to indicate any problems with the plain English format. The NCUA Board believes the question and answer format will lessen misunderstandings and is comprehensive and easy to understand. The NCUA Board does not believe a supplementary information section in the final rule is necessary. Therefore, the final rule is written in this format.

NCUA proposed moving the rule from Part 701 to Part 723 of NCUA's Regulations. Five commenters approved placing the member business loan rule in its own Part. The NCUA Board agrees and the final rule will be in Part 723.

Proposed Section 723.1—What is a Member Business Loan?

This section provides a definition of a member business loan. The proposal defined a member business loan as any loan, line of credit, or letter of credit where the borrower uses the proceeds for the following purposes: commercial, corporate, investment property, business venture or agricultural. This definition was slightly different from the current rule in that the proposal deletes the term ''business'' from ''business investment property.'' However, NCUA may no longer define what is a member business loan by

regulation because the Act defines the term. Therefore, a member business loan means any loan, line of credit or letter of credit, the proceeds of which will be used for a commercial, corporate or other business investment property or venture, or agricultural purpose. Section 107A(c)(1)(a) of the Act.

Proposed Section 723.1(b)—Exceptions to the General Rule?

This section sets forth the exceptions to the definition of a member business loan. NCUA proposed to increase the dollar threshold at which the rule applies from $50,000 to $100,000. Fifteen commenters supported the new threshold. Some of these commenters believe the change would help small and low-income credit unions. However, the Act sets forth the applicable exceptions to the definition of a member business loan. The dollar threshold is set at $50,000.

The new regulation sets forth five exceptions that are virtually identical to the exemptions in the current member business loan regulation. The following loans are exempt from the member business loan definition: (1) an extension of credit that is fully secured by a lien on a 1-to-4 family dwelling that is the primary residence of a member; (2) an extension of credit that is fully secured by shares in the credit union making the extension of credit or deposits in financial institutions; (3) an extension of credit that meets the member business loan definition made to a borrower or an associated member that has a total of all such extensions of credit in an amount equal to or less than $50,000; (4) an extension of credit the repayment of which is fully insured or fully guaranteed by, or where there is an advance commitment to purchase in full by, an agency of the Federal Government or of a State, or any political subdivision thereof; or (5) an extension of credit that is granted by a corporate credit union (as that term is defined by the Board) to another credit union.

Proposed Section 723.2—What are the prohibited activities?

NCUA proposed no substantive changes from the current rule, except to add senior management employees and officials to the provision prohibiting equity agreements or joint ventures. Four commenters agreed with NCUA that senior management employees and officials should be prohibited from receiving income tied to a business loan the credit union makes. Two opposed the proposal.

One commenter believed it would be inconsistent to prohibit non-compensated officials from entering into equity agreements and joint ventures involving business loans while permitting credit unions to make business loans to those officials. However, this commenter agreed with the proposal to extend the prohibition against equity agreements and joint ventures involving business loans to senior management employees as long as NCUA excludes non-compensated officials from the prohibition. The NCUA Board agrees and has incorporated this change into the final rule.

Two commenters believed that the current prohibition on senior management officials receiving business loans should be eliminated. The NCUA Board has not been provided with any convincing reason to eliminate the prohibition. One commenter correctly pointed out that the title to this section should be changed to ''who is ineligible to receive a member business loan.'' This commenter stated that otherwise it would make senior management employment a prohibited activity. The NCUA Board agrees and has retitled the section accordingly.

Proposed Section 723.3—What are the requirements for construction and development lending?

This section sets forth the requirements for construction and development lending. NCUA proposed no substantive changes to this section from the current rule. NCUA clarified that construction and development loans below the dollar limits, individually and/or in the aggregate, are not considered to be member business loans for the purpose of this rule. Thus, if a member has a construction loan for $40,000, and no other outstanding business type loans, including unfunded business type lines of credit, then the construction loan is not a member business loan. No substantive comments were received on this section. The NCUA Board is adopting this section in final as proposed.

Proposed Section 723.4—What are the other applicable regulations?

This section merely describes the other lending rules credit unions must follow when granting member business loans to the extent they are consistent with this regulation. NCUA proposes no substantive changes from the current rule. One commenter objected to incorporating Sections 701.21(a) through (g) of NCUA's regulations into this regulation. One commenter supported this provision. The NCUA Board has not been provided with any convincing reason to change this section, so it is adopting it in final as proposed.

Proposed Section 723.5—How do I implement a member business loan program?

This section requires the board of directors to adopt business loan policies and review them at least annually. This section also requires the board to use the services of an individual with at least two years direct experience in the type of lending in which the credit union will be engaging. The preamble to the proposal also clarified that NCUA has never required experience with business loans in general but, rather, has required experience with making loans the credit union intends to grant. The preamble also clarified that credit unions need not hire staff to meet the requirements of this section; however, credit unions must ensure that the expertise is available. Credit unions can meet the experience requirement through various approaches. For example, a credit union can use the services of a CUSO, an employee of another credit union, an independent contractor, or other third parties. However, the actual decision to grant a loan must reside with the credit union.

Two commenters supported NCUA's clarification that the rule does not require two years experience specifically in business lending. Two commenters did not believe there would be any hindrances in obtaining a staff person with two years relevant lending experience. Two commenters believe it is difficult to find someone who has the relevant experience for every type of commercial loan. One commenter stated that the real issue is having the money to hire such experienced people.

Two commenters recommended eliminating the two-year experience requirement. Two commenters believed NCUA should allow credit unions to address qualifications based on what the credit union desires. One commenter agreed with the new language but believed it is still overly restrictive and represents an attempt to micromanage credit unions.

One commenter appreciated NCUA's clarification that the requirement to retain staff with two years of experience does not mean specific business lending experience. This commenter stated that allowing two years of lending experience to suffice without a specific requirement for business lending experience, coupled with the ability of a credit union to use CUSO services, an employee from another credit union, or a contractor, will remove a business lending impediment for many credit unions.

The NCUA Board believes it is crucial for a credit union to have experienced personnel involved in making decisions regarding business lending. Member business loans require special expertise in virtually all phases of origination and administration. Prior to NCUA's imposition of the experience requirement, a number of credit unions suffered losses from member business loans as a result of poorly structured and administered loans. Most of these problems could have been avoided had the credit union been better informed and prepared through the use of experienced personnel. Therefore, the NCUA Board is continuing to require credit unions instituting member business loan programs to retain personnel with two years of business lending experience.

Two commenters requested that the final regulation contain some of the examples in the preamble to the proposal of proper arrangements such as the use of a CUSO or an employee of another credit union. The Board agrees and the final rule contains examples of how to fulfill the two-year requirement.

Proposed Section 723.6—What must our member business loan policies address?

This section sets forth those items that credit unions must address in their written business loan policies. The proposal adds a new requirement for credit unions to review financial statements. One commenter believed it is overly burdensome to review and analyze the member's entire financial statements instead of reviewing updates. Five commenters did not believe it would be excessively burdensome. After further consideration, the NCUA Board does not see any significant benefit in requiring a review of financial statements on all member business loans. In most cases, a credit union engaging in business lending will ordinarily review the financial statements of its open-end business loans. Therefore, the final rule does not require credit unions to review financial statements.

The proposal also changes the term ''appraisals'' to ''determination of value.'' The wording in the current rule unduly emphasizes member business loans as real estate loans. The proposed wording clarifies that, whether a member business loan is for real estate or non-real estate, credit unions must meet the collateral requirements. The proposal also changes the term ''title search'' to ''determination of ownership'' for the same reason.

One commenter believed the present regulatory distinction between real estate secured business loans and other business loans is often blurred and that the proposed new regulation does little to recognize this distinction. This commenter stated that the terms used in this regulation are more applicable to real estate lending. Another commenter suggested that NCUA consider two distinct classes of member business loans: one for real estate, incorporating underwriting criteria such as higher loan-to-value ratios, owner occupancy standards, lien position requirements, longer loan terms; and one for other types of business loans, with flexible underwriting criteria appropriate to the specific loan. Although there is a distinction between real estate secured business loans and other types of business loans, the NCUA Board believes the stated requirements are necessary for both. The NCUA Board believes the proposed changes in language will be helpful to credit unions in making business loans.

The proposal also clarified that the maturity of a member business loan may not exceed twelve years. The proposal inadvertently failed to exclude federally insured state chartered credit unions from this requirement as NCUA has consistently done in the past. Nine commenters stated that the twelve-year maturity limit should not apply to state chartered credit unions. NCUA agrees and the final rule permits state chartered credit unions to grant business loans with a maturity limit consistent with state law. Five credit unions requested that the twelve-year maturity limit be increased for federal credit unions. This is currently impermissible for federal credit unions since the Federal Credit Union Act limits such loans to twelve years.

Proposed Section 723.7—What other items must the member business loan policy address?

This section sets forth the remaining issues that written loan policies must address, including loan-to-value ratios and the requirement for the personal liability and guarantee of the member. The proposal increases the second lien limitation from 70% to 80% for collateral ratios. The proposal also clarifies that private mortgage insurance for first liens with a loan-to-value ratio exceeding 80% applies only to real estate loans. Twelve commenters supported the increase in the second lien limitation from 70% to 80%. However, some commenters questioned whether the same stringent loan-to-value ratios would be required for loans on personal properties, vehicles and equipment. They believed that NCUA's approach could hinder the competitiveness of credit unions wanting to provide business loans to their members. One commenter believed the second lien limitation should be increased further while another commenter believed the 70% loan-to-value is adequate. Two commenters believed that credit unions need more flexibility for loan to value ratios. One commenter believed NCUA should allow loan-to-value ratios up to 100%. The NCUA Board believes the specified loan limits are appropriate for member business loans and has incorporated them into the final rule.

One commenter stated that the regulation should be clarified so that the loan-to-value ratios for business loans are applicable only for member business loans. For example, if a business loan for $50,000 is granted on an unsecured basis and if an additional $40,000 is granted to the borrower, only $40,000 would be subject to the loan-to-value limitations. The Board agrees that only that portion of member business loans in excess of $50,000 are subject to the loan-to-value limitations. However, if the two loans are on the same collateral, the loan-to-value limitation will apply to the aggregate amount of the loans. For example, if the credit union makes a loan on a piece of real estate for $40,000 and subsequently makes another $40,000 loan on the same collateral, the loan-to-value limitation will apply to the entire $80,000.

This proposed section would also allow any credit union to seek a waiver from the loan-to-value ratios for a particular business loan program. Five commenters agreed with expanding the waiver provision to permit credit unions that recently initiated member business loan programs to seek an exemption from loan-to-value limitations. The final rule includes this waiver authority from the loan-to-value limitations.

The proposal exempts federally insured credit unions from the loan-to-value ratios with respect to credit card line of credit programs offered to nonnatural persons that are limited to routine purposes normally made under those programs. One commenter supported this proposal. One commenter erroneously believed this section did not apply to federal credit unions.

Proposed Section 723.8—How much may one member or a group of associated members borrow?

This section sets forth the aggregate amount of outstanding member business loans that credit unions may grant to one member or a group of associated members. Unless NCUA grants a waiver, the proposal limits the aggregate amount of outstanding business loans to any one

member or group of associated members to 15% of the credit union's reserves (less the Allowance for Loan Losses account) or $100,000, whichever is higher. Six commenters agreed with the 15% threshold although one commenter would delete the dollar threshold. One commenter requested that the 15% limit be increased. The NCUA Board has not been provided with a convincing rationale for raising the 15% limit and is adopting the proposal in final.

The NCUA Board is clarifying how loan participations are treated in regard to business loan limits. In those situations where the credit union sold the participation without recourse, the amount sold would not be included when calculating the 15% limit for a single borrower. However, if the credit union sold the participation with recourse (that is, the selling credit union essentially retains a contingent liability), it would include the amount sold when calculating the 15% limit.

The NCUA Board is also clarifying that the aggregate amount of outstanding member business loans to any one member includes any unfunded commitments.

Proposed Section 723.9—How do I calculate the aggregate 15% limit?

The current rule states that, if any portion of a member business loan is secured by shares in the credit union or a deposit in another financial institution, or fully or partially insured or guaranteed by, or subject to an advance commitment to purchase by any agency of the federal government or of a state or any of its political subdivisions, such portion is not used in calculating the 15% limit. NCUA proposed no substantive changes to the current rule on the calculation of the 15% limit. Some credit unions have asked NCUA staff whether the partial guarantee by a federal agency includes loans guaranteed by the Small Business Administration. The amount of the loan guaranteed by the Small Business Administration is not used in calculating the 15% limit.

For the purpose of being consistent with proposed section 723.1(b), NCUA proposed to change the term ''financial institution'' in this section to ''federally insured financial institution.'' Since the Act, in setting forth the exceptions to the member business loan definition, does not require the financial institution to be federally insured, NCUA is not adopting this change.

Proposed Section 723.10—What loan limit waivers are available?

The proposal provides for a waiver from: (1) the maximum loan amount to one borrower or associated group of members; (2) loan-to-value ratios; and (3) construction and development lending. Although a number of commenters approved of the waiver provision, twelve commenters specifically questioned whether the waivers apply to individual loans or to a category of loans. The intent of the proposal was to exempt categories of loans. A loan-by-loan waiver would be unworkable and overly burdensome for credit unions and NCUA. The final rule clearly states that the waiver is for a category of loans.

Proposed Section 723.11—How do I obtain an available waiver?

This section describes the information that a credit union must submit to the Regional Director with a waiver request. NCUA proposed no substantive changes to the requirements of the current rule. However, in the interim final rule, the NCUA Board is providing a mechanism for state chartered federally insured credit unions to have the waiver request processed through the state supervisory authority.

Proposed Section 723.12—What will NCUA do with my waiver request?

This section addresses what the Regional Director must consider in reviewing the waiver request and how the waiver is processed. The proposal increased the number of days from 30 to 60 that a Regional Director must act on a waiver request. It also eliminated the automatic waiver approval if a region does not take action on a request within the specified timeframe. Twelve commenters believed that the number of days NCUA should have to process the waiver should be limited to 30 days and the automatic waiver provision should be reinstated. A few commenters requested that NCUA have less than 30 days to approve or disapprove the request. One commenter asked that NCUA clarify whether there are any time limits once a waiver has been approved. The NCUA Board is extending the number of days the agency has to process the waiver to 45 days (from the receipt from the federal credit union or the state supervisory authority) and has restored the automatic waiver approval if a region does not take action on a request within the specified timeframe. Any waiver is revocable in NCUA's sole discretion. If a waiver is revoked, loans granted under the waiver authority are grandfathered.

Proposed Section 723.13—What options are available if the Regional Director denies our waiver request or a portion of it?

Under the current rule, a credit union may appeal the denial of its waiver request by the Regional Director to the NCUA Board. NCUA proposed no substantive changes to this area and no substantive comments were received. The Board is adopting this section in final as proposed.

Proposed Section 723.14—How do I reserve for potential losses?

Consistent with the current rule, this section addresses the criteria for determining the classification of loans. NCUA proposes no substantive changes to the loan classification. However, NCUA proposes to move the current Appendix of Section 701.21(h) to this proposed section. No substantive comments were received on this section. The Board is adopting this proposed section in final.

Proposed Section 723.15—How much must I reserve for potential losses?

This section provides a schedule a credit union must use to reserve for classified loans. NCUA proposes no substantive changes to this schedule from the current rule. However, NCUA clarified the meaning of this section by stating that this is the minimum amount when establishing the reserve percentage. One commenter opposed the mandatory reserve requirement. The Board believes the current requirement is working well and is retained as proposed.

New Section 723.16—What is the aggregate member business loan limit?

The Act imposes a new aggregate limit on a credit union's outstanding member business loans (including any unfunded commitments) of the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets. Net worth is all of the credit union's retained earnings. Retained earnings normally includes undivided earnings, regular reserves and any other reserves. If a credit union currently has business loans that exceed the aggregate loan limit and does not qualify for an exception, it has until August 7, 2001 to reduce the total amount of outstanding member business loans or below the aggregate loan limit. Furthermore, an insured credit union that is undercapitalized may not make any new business loans until such time the credit union becomes adequately capitalized as required by the prompt corrective action provisions of the Credit Union Membership Access Act of 1998.

New Section 723.17—Are there any exceptions to the aggregate loan limit?

The Act sets forth three exceptions to the aggregate limit: (1) credit unions that have a low-income designation or participate in the Community Development Financial Institutions program; (2) credit unions that have a ''a history of primarily making member business loans,'' or (3) credit unions that were chartered for the purpose of primarily making member business loans.

A credit union that does not currently have a low-income designation and is seeking to determine whether it qualifies should contact its regional director or the appropriate state supervisor. The Board is defining ''a history of primarily making member business loans'' as either (1) member business loans that comprise at least 25% of the credit union's outstanding loans (as evidenced in a call report for 1998 or any of the three prior years); or (2) member business loans comprise the largest portion of the credit union's loan portfolio. For example, if a credit union makes 23% member business loans, 22% first mortgage loans, 22% new automobile loans, 20% credit card loans and 13% other real estate loans, then the credit union would be considered as meeting the primarily making business loan standard. For determining the categories of loans the credit union should use loan categories that are similar to those set forth in the call report such as: unsecured credit card loans/lines of credit; all other unsecured loans/lines of credit; new vehicle loans; used vehicle loans; total first mortgage loans; total other real estate loans; total member business loans. NCUA estimates that less than 70 credit unions, out of a total of 11,125 federally insured credit unions, will qualify for either of these exceptions.

An exception may also be granted for credit unions that were chartered for the purpose of primarily making member business loans. It is up to the credit union to provide sufficient documentation to demonstrate it meets this exception. Due to the nature of federal chartering it is unlikely that many federal credit unions will qualify for this type of exception. Furthermore, the NCUA Board is seeking comment on how it can more fully define credit unions that were ''chartered for the purpose of * * * primarily making business loans'' for the purpose of the exception.

A credit union that does not qualify for an exception must immediately stop making business loans that will exceed the aggregate loan limit. Credit unions that, in good faith, believe they qualify for an exception can continue to make new member business loans as long as they have applied for an exception.

New Section 723.18—How do I obtain an exception?

To obtain the exception, a federal credit union must submit documentation to the Regional Director, demonstrating that it meets the criteria of one of the exceptions. The regional director will process requests for exemptions expeditiously for federal credit unions. Although NCUA believes most exceptions will be granted in 1998 it is possible for a credit union to qualify in the future. For example, a credit union that receives a low-income designation in the year 2001 could apply for and receive an exception on that basis.

A state chartered federally insured credit union must submit documentation to its state regulator to receive the exception. Although effective when granted by the state regulator, the state regulator should forward its decision to NCUA.

The exception does not expire unless revoked by the regional director for a federal credit union or by the state regulator for a federally insured state chartered credit union. If an exception is revoked, loans granted under the exception authority are grandfathered.

If an exception request is denied for a federal credit union, it may be appealed to the NCUA Board within 60 days of the denial by the regional director. A federal credit union can continue to make business loans until the NCUA Board decides the appeal.

Proposed Section 723.16—What are the recordkeeping requirements?

This proposed section, consistent with the current rule, requires a credit union to identify member business loans separately in its records and financial reports. NCUA proposed no substantive changes to this requirement from the current rule. Four commenters believed that this recordkeeping would be burdensome and unnecessary. NCUA believes it is important for credit unions as well as NCUA to be able to monitor business lending activity. Therefore, the Board is not making any changes to this section in the final rule, except to renumber it as Section 723.19.

Proposed Section 723.17—What additional steps do federally insured state chartered credit unions have to perform?

In the preamble to the proposal, the Board stated that it believes it is important for state supervisory authorities to remain aware of, and involved in, member business loan activities in federally insured state chartered credit unions. This new section would require federally insured state chartered credit unions to obtain written approval for a waiver from their state supervisory authority prior to submitting the waiver request to NCUA. Three commenters questioned why NCUA believes it is necessary to have this section. The commenters asked what would happen if a state had no policy on waivers and declined to rule on the waiver. These commenters believed this provision simply makes it more difficult for a state chartered federally insured credit union to obtain a waiver and that it makes little sense to restrict state chartered credit unions in such a manner.

It appears that some of the commenters believed the waiver process was on a loan-by-loan basis instead of a category loans. The NCUA Board still believes it is important for state supervisory authorities to be involved in waivers from the member business loan rule. Therefore, Section 723.11 requires a federally insured state chartered credit union to process its waiver request through the state supervisory authority. The NCUA Board believes the state supervisory authorities will expeditiously process this request and there will only be a minimal increase in time in processing waivers from state chartered federally insured credit unions. NCUA will not approve a waiver request that the state supervisory authority has not forwarded to NCUA or a request that the state supervisory authority recommends denial.

Proposed Section 723.18—How can a state supervisory authority develop and implement a member business loan regulation?

As in the current rule, the proposal allows a federally insured state chartered credit union to obtain an exemption from NCUA's member business rule so that a state supervisory authority can enforce the state's rule instead of NCUA's rule. The NCUA Board must approve the state's rule before a federally insured state chartered credit union is exempt from NCUA's member business loan rule. To provide better guidance to the states, the proposal identifies the minimum requirements that they must address for a rule to be approved by the NCUA Board. One commenter opposes the application of NCUA's member business rule to federally insured state chartered credit unions and requests that it be eliminated for them. Past practice has indicated the importance of this rule

being applied to state chartered federally insured credit unions. However, the NCUA Board recognizes the concerns of the state supervisory authorities and the interim final rule modifies this section to demonstrate that the NCUA Board in reviewing a state's rule is concerned, as insurer, with the safety and soundness issues presented by the rule and not whether the language of the rule is virtually identical to NCUA's rule.

Three commenters questioned whether the adoption of the revised rule by NCUA automatically means a state's rule is no longer ''substantially equivalent.'' Because of the new statutory requirements of the Act, no state rule is currently approved for use by federally insured state chartered credit unions. Therefore, states must seek a new determination from NCUA.

Three commenters encouraged the NCUA Board to allow more flexibility in the interpretation of what is ''substantially equivalent'' where safety and soundness can be maintained. In making its determination to approve a state's rule, the Board is primarily concerned with safety and soundness considerations, and that is why the minimum standards for such a determination are set forth in the regulation.

Because proposed section 723.17 is deleted from the final rule, this section is renumbered as Section 723.20.

Proposed Section 723.19—Definition

NCUA proposed a general definition section at the end of the rule. This section clarified the loan-to-value ratio by including terminology that requires the inclusion of unfunded commitments and/or lines of credit when determining the aggregate sum. Six commenters believed NCUA should require credit unions to include unfunded commitments and/or lines of credit in the aggregate sum to determine loan-to-value ratios. One commenter disagreed. The NCUA Board is adopting in final the proposal to include unfunded commitments and/or lines of credit in the aggregate sum for loan-to-value determinations since this is the total amount that the credit union agreed to loan to the borrower. However, this section in the final rule is numbered section 723.21.

Miscellaneous

One commenter requested that the preamble or final regulation state that credit scoring is permitted to assist in determining the credit worthiness of a business loan applicant. Although not stated in the regulation, we note that credit scoring that complies with equal credit opportunity laws is permitted in evaluating the credit worthiness of a business loan applicant.

Part 722—Appraisals

Certain loans as specified in Section 722.3(a) do not require an appraisal. In addition, the NCUA Board proposes a waiver process from the appraisal requirement where the appraisal requirement is an unnecessary burden. Eight commenters supported the waiver appraisal provision, although there was some confusion on whether it applied to a loan program or individual loans. The intent of the proposal was to apply to a loan program. The final rule reflects that the waiver applies to a loan program. Three commenters objected to having a waiver process. The NCUA Board does not believe that a waiver process will have a negative effect on the safety and soundness of credit unions.

C. Other Reductions in Regulatory Burden

Under the current rule, all loans, lines of credit, or letters of credit that meet the definition of a member business loan must be separately identified in the records of the credit union and be reported as such in financial and statistical reports required by the NCUA. NCUA believes that this information is already collected, and readily available, through the 5300 Call Report. The current requirement imposes an unnecessary burden on credit unions and, therefore, the NCUA Board is deleting this monitoring requirement.

The current rule requires credit unions to provide periodic disclosures to credit union members on the number and aggregate dollar amount of member business loans. NCUA believes the language is ambiguous and does not serve any true safety or soundness issue or concern. Therefore, the NCUA Board is deleting this requirement.

Current § 701.21(c)(5) references the member business loan section. Due to the proposed change to the member business loan rule numbering system, NCUA is updating § 701.21(c)(5) to reference the appropriate sections of the final rule.

D. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small entities (primarily those under $1 million in assets). The final member business loan rule would reduce existing regulatory burdens. In addition, most small credit unions do not grant member business loans. Therefore, the NCUA Board has determined and certifies that the final rule will not have a significant economic impact on a substantial number of small credit unions. Accordingly, the Board has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

The reporting requirements in part 723 have been submitted to the Office of Management and Budget for approval and the OMB number will be published as soon as it is received by NCUA. Under the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless it displays a valid OMB control number. The control number will be displayed in the table at 12 CFR Part 795.

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. The final rule, as does the current rule, applies to all federally insured credit unions, including federally insured state chartered credit unions. However, since the final rule reduces regulatory burden, NCUA has determined that the final rule does not constitute a ''significant regulatory action'' for purposes of the Executive Order.

Congressional Review

The Office of Management and Budget has determined this is not a major rule.

List of Subjects

12 CFR Part 701

Credit, Credit unions, Insurance, Mortgages, Reporting and recordkeeping requirements, Surety bonds.

12 CFR Part 722

Appraisals, Credit, Credit unions, Reporting and recordkeeping requirements, State-certified and State-licensed appraisers.

12 CFR Part 723

Credit, Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 741

Bank deposit insurance, Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on September 23, 1998.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 701 and 724

Organization and Operation of Federal Credit Unions; Trustees and Custodians of Pension Plans

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final Rule.

SUMMARY: NCUA is adopting as final the interim final amendments to part 724 regarding federal credit unions acting as trustees and custodians of pension and retirement plans and part 701 regarding retirement benefits for federal credit union employees that were issued in March, 1998. The final amendments revise part 724 to authorize federal credit unions to act as trustees and custodians for Roth IRAs and Education IRAs. The final amendments also conform part 701 to be consistent with the changes made to part 724.

DATES: Effective January 1, 1998.

ADDRESSES: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia, 22314–3428.

FOR FURTHER INFORMATION CONTACT: Frank S. Kressman, Staff Attorney, at the above address, or telephone at (703) 518–6540.

SUPPLEMENTARY INFORMATION:

Interim Final Rule

On March 13, 1998, NCUA issued an interim final rule that made the above summarized substantive and conforming revisions to part 724 and part 701. It became effective upon its publication in the **Federal Register** on March 24, 1998. 63 FR 14025, March 24, 1998. In response to a request for comment made in the interim final rule, NCUA received four comment letters, three from trade associations and one from a federal credit union. Each of the four commenters supported the final amendments and also provided additional comments, as discussed below.

The interim final rule provides that federal credit unions are authorized to act as trustees and custodians of Roth IRAs and Education IRAs. Such authority is in addition to those trustee and custodian services that federal credit unions have been authorized to provide for other kinds of pension and retirement plans for approximately the past twenty-three years. Two commenters noted that many federal credit unions began acting as trustees and custodians of Roth IRAs and Education IRAs as early as January 1, 1998, the date on which such accounts were available to consumers, and that many other federal credit unions did the same between January 1, 1998 and March 23, 1998. Each of these two commenters voiced a concern that such action, having been taken by federal credit unions in advance of the effective date of the interim final rule, could leave many federal credit unions and Roth IRA and Education IRA account holders subject to possible tax liability or other regulatory difficulties. Specifically, each of these commenters noted that, because NCUA did not technically provide federal credit unions with regulatory authority to act as trustees and custodians for such accounts prior to March 24, 1998, accounts opened prior to that date might be viewed as failing to qualify for the intended tax treatment under the Internal Revenue Code. Under such circumstances, holders of Roth IRA and Education IRA accounts opened prior to March 24, 1998, with regular contributions or especially via a roll-over from another qualifying plan, could face severe tax consequences and other significant financial hardships. Accordingly, the commenters urged NCUA to make this final rule effective retroactively to January 1, 1998. The tax benefits available to individuals through Roth IRA and Education IRA accounts arise through amendments to the Internal Revenue Code. Those amendments became effective for tax payers as of January 1, 1998. Through the same IRA amendments, FCUs' existing statutory authority was expanded. In the Board's view, any limitation resulting from the wording of NCUA's regulations would raise a technical regulatory violation for an FCU, not a tax problem for individual account holders. Nevertheless, to avoid any undesirable consequences, cure unintended results and relieve federal credit unions acting as trustees and custodians of Roth IRAs and Education IRAs of unnecessary restrictions, NCUA makes this final rule retroactively effective as of January 1, 1998. 5 U.S.C. 553(d)(1).

The remaining two commenters requested NCUA to amend or otherwise provide clarification regarding the authority of federal credit unions to act as trustees and custodians of state and federal Medical Savings Accounts (MSAs). One of these commenters also indicated its preference for NCUA to move forward in this regard with a request for comment, rather than an advanced notice of proposed rulemaking. As indicated in the interim final rule, NCUA requested comment pertaining only to Roth IRAs and Education IRAs. NCUA made a request for comment in this manner because to amend part 724 and part 701 to address MSAs would entail extensive modifications or possibly a new rule and would unduly delay satisfying the more immediate need to implement the final amendments pertaining to Roth IRAs and Education IRAs. The NCUA agrees with the commenters that the role of federal credit unions with respect to the administration of MSAs is an issue that warrants regulatory review and intends to conduct such a review in a timely fashion.

In summary, NCUA is adopting the interim final amendments in final, without any changes, except to make such amendments effective as of January 1, 1998.

Regulatory Procedures

Regulatory Flexibility Act

This final rule conforms the current regulation to recent changes in the federal tax law and does not expand upon the nature of the activity authorized for federal credit unions. The Board has determined and certifies that this rule will not have a significant economic impact on a substantial number of small credit unions. Accordingly, NCUA has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

This final rule does not impose any paperwork requirements.

Executive Order 12612

This final rule only applies to federal credit unions. It has no affect on the regulation of state-chartered credit unions.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The Office of Management and Budget has reviewed this rule and has determined that for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 this is not a major rule.

List of Subjects

12 CFR Part 701

Credit unions.

12 CFR Part 724

Credit unions, Pensions, Reporting and recordkeeping requirements, Trusts and trustees.

By the National Credit Union Administration Board, this 23rd day of September, 1998.

Becky Baker,

Secretary, NCUA Board.